

Set-Off in South African Law: Challenges and Opportunities

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Thesis presented in fulfilment of the requirements for the degree of
Master of Law in the Faculty of Law at Stellenbosch University



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March 2016

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March 2016

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ABSTRACT

This study focuses on the principles surrounding the operation of set-off in South African law. It is evident that no uniform answer exists to the question of how set-off operates: it either operates automatically as soon as its requirements are met or in terms of a declaration by one of the parties, but with retrospective effect. This thesis examines the uncertainty and problems surrounding these two opposing approaches to the operation of set-off, and further considers the impact of sections 90 and 124 of the National Credit Act 34 of 2005 (NCA) on set-off.

In order to evaluate the two approaches to set-off, their historical origin, practical effect and the policy considerations informing them are analysed. This analysis is also informed by comparative perspectives on the operation of set-off adopted in civilian jurisdictions. The thesis further examines the circumstances in which a party will be precluded from relying on set-off. It focuses on an agreement between the parties to exclude set-off, waiver of a party's right to set-off and the circumstances in which a party can be estopped from invoking set-off.

It is shown that neither of the approaches to set-off adopted in South African law provides an adequate explanation for the way in which set-off is applied in practice. The thesis illustrates that this can be attributed to the fact that the automatic approach affords insufficient recognition to the autonomy of contracting parties and that the retrospective approach leads to practical difficulties. The uncertainties which exist regarding the exclusions of the right to invoke set-off are also highlighted, as well as the difficulty in reconciling these exclusions with the automatic approach to set-off.

The examination of sections 90 and 124 of the NCA focuses on the interpretation of these sections, and considers whether and to what extent, a limitation on a credit provider's right to invoke set-off is desirable. It is concluded that these sections are unclear and that, although certain limitations of a credit provider's right to invoke set-off are justified, the conditions set by the NCA are too stringent. Legislative reforms are suggested to clarify and improve the protection granted by the NCA.

Finally, it is argued that South African courts should take note of international developments regarding the operation of set-off and opt for a solution which is more

in line with modern commercial reality. Such a solution can be found in the UNIDROIT Principles of International Commercial Contracts and the Principles of European Contract Law, which recommend that set-off should be effected by a notice with prospective effect. It is shown that this approach ensures legal certainty and offers a solution which aligns legal and practical reality.

OPSOMMING

Hierdie studie fokus op die beginsels rakende die werking van skuldvergelyking in die Suid-Afrikaanse reg. Dit blyk dat geen eenvormigheid bestaan oor die wyse waarop skuldvergelyking plaasvind nie: dit vind òf outomaties plaas sodra die vereistes aan voldoen is òf in terme van 'n verklaring deur een van die partye, maar met terugwerkende effek. Hierdie tesis ondersoek die onsekerheid en probleme ondervind met hierdie twee teenstrydige benaderings tot die werking van skuldvergelyking, en oorweeg verder die impak van artikels 90 en 124 van die Nasionale Kredietwet 34 van 2005 (NKW) op skuldvergelyking.

Ten einde die twee benaderings tot skuldvergelyking te evalueer, word hul historiese oorsprong, praktiese effek en die relevante beleidsoorwegings ontleed. Hierdie ontleding steun ook op 'n regsvergelykende perspektief op die werking van skuldvergelyking in sivilregtelike jurisdiksies. Die tesis ondersoek verder die omstandighede waaronder 'n party verhoed sal word om op skuldvergelyking te steun. Dit fokus op 'n ooreenkoms tussen die partye om nie op skuldvergelyking te steun nie, afstanddoening van 'n party se reg tot skuldvergelyking en die omstandighede waaronder estoppel 'n beroep op skuldvergelyking sal verhoed.

Daar word aangedui dat geeneen van die benaderings tot skuldvergelyking gevolg in die Suid-Afrikaanse reg 'n voldoende verduideliking bied van die wyse waarop skuldvergelyking in die praktyk toegepas word nie. Hierdie tesis illustreer dat dit toegeskryf kan word aan die feit dat die outomatiese benadering onvoldoende erkenning gee aan die outonomie van kontrakspartye, asook die praktiese probleme ondervind deur die terugwerkende benadering. Die onsekerheid wat bestaan rakende die uitsluitings van die reg om op skuldvergelyking te steun word ook uitgelig, asook die onversoenbaarheid van hierdie uitsluitings met die outomatiese benadering tot skuldvergelyking.

Die ondersoek na artikels 90 en 124 van die NKW fokus op die interpretasie van hierdie artikels, en oorweeg ook of en tot watter mate 'n beperking op die reg van 'n kredietverskaffer om op skuldvergelyking te steun wenslik is. Daar word bevind dat hierdie artikels van die NKW onduidelik is en dat, alhoewel sekere beperkings op die reg van 'n kredietverskaffer om op skuldvergelyking te steun regverdigbaar is, die

voorwaardes gestel deur die NKW te streng is. Statutêre wysigings word voorgestel om die beskerming gebied deur die NKW uit te klaar en te verbeter.

Ten slotte word daar aangevoer dat Suid-Afrikaanse howe kennis moet neem van internasionale verwickelinge rakende die werking van skuldvergelyking en 'n oplossing moet nastreef wat meer in lyn is met hedendaagse kommersiële realiteit. Sodanige oplossing kan gevind word in die *UNIDROIT Principles of International Commercial Contracts* en die *Principles of European Contract Law*, wat aanbeveel dat skuldvergelyking moet geskied deur middel van 'n kennisgewing met vooruitwerkende krag. Daar word aangedui dat hierdie benadering regsekerheid verseker en 'n oplossing bied wat juridiese en praktiese werklikheid versoen.

ACKNOWLEDGEMENTS

I would like to express my sincere thanks and appreciation to my supervisors, Prof Jacques du Plessis and Dr Franziska Myburgh, for their guidance and invaluable input in drafting this thesis. I am greatly indebted to them for all the time and energy that went into helping shape this thesis, and their patience and sound advice is greatly appreciated. I could not have asked for more dedicated supervisors. It was also a privilege and wonderful learning opportunity to work for them.

I gratefully acknowledge the financial assistance of Stellenbosch Law Faculty towards the completion of this thesis.

Op 'n persoonlike noot is ek dankbaar teenoor my ouers, Neels en Alba Muller, vir hulle volgehoue ondersteuning in al my besluite en dat hulle altyd in my glo. Ek is hulle ook baie dank verskuldig vir hulle finansiële steun tydens my voorgaadse studies.

'n Groot dankie aan my vriende, broer, suster, skoonouers en selgroep wat nie moeg geraak het van vra hoe die tesis vorder nie en vir die vreugde wat hulle in my lewe is.

My grootste dank gaan aan my man, Cor. Sonder sy liefde, ondersteuning, aanmoediging en ewige optimisme sou hierdie tesis nie moontlik gewees het nie, en dit word aan hom opgedra.

Laastens, dankie aan my Hemelse Vader, my bron van krag.

LIST OF ABBREVIATIONS

<i>Calif L Rev</i>	<i>California Law Review</i>
Code	Code of Banking Practice
<i>Int'l Fin L Rev</i>	<i>International Financial Law Review</i>
<i>JBL</i>	<i>Juta's Business Law</i>
<i>LAWSA</i>	<i>Law of South Africa</i>
NCA	National Credit Act 34 of 2005
NCR	National Credit Regulator
PECL	Principles of European Contract Law
PICC	UNIDROIT Principles of International Commercial Contracts
<i>SALJ</i>	<i>South African Law Journal</i>
<i>SA Merc LJ</i>	<i>South African Mercantile Law Journal</i>
<i>Stell LR</i>	<i>Stellenbosch Law Review</i>
<i>THRHR</i>	<i>Tydskrif vir Hedendaagse Romeins-Hollandse Reg / Journal of Contemporary Roman-Dutch Law</i>
<i>TR</i>	<i>Tijdschrift voor Rechtsgeschiedenis</i>
<i>TSAR</i>	<i>Tydskrif vir die Suid-Afrikaanse Reg / Journal of South African Law</i>
<i>Tul Eur & Civ LF</i>	<i>Tulane European and Civil Law Forum</i>
UNIDROIT	International Institute for the Unification of Private Law
<i>Wm. & Mary Law Review</i>	<i>William & Mary Law Review</i>

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CHAPTER 1: INTRODUCTION

1.1 Problem identification

Set-off is one method by which obligations, whether arising contractually or otherwise (for instance *ex delicto*), can be terminated without requiring the exchange of performances.¹ It operates where two parties are mutually indebted to each other² and extinguishes obligations as effectively as if they have been discharged by performance.³ If the debts are for the same amount, both are extinguished simultaneously; if not, the smaller debt is extinguished while the larger debt is reduced by the amount of the smaller.⁴

Set-off is often regarded as a form of payment⁵ and operates *pro tanto* as if payment was made.⁶ However, these two methods of debt-extinction must be differentiated.⁷ Set-off does not require an agreement between the parties⁸ and does not entail the physical exchange of money⁹ or the electronic transfer of funds.¹⁰

The basic premises regarding the effect of set-off are thus straightforward: if A owes B R100, and B is indebted to A in the amount of R100, there is little practical benefit for the parties to pay these debts to each other, although legally these payments are required to release them from their respective obligations.¹¹ To prevent this back-and-forth payment, the law allows the debts to be extinguished by set-off. The difficulty,

¹ JC de Wet & AH van Wyk *Die Suid-Afrikaanse Kontraktereg en Handelsreg* 1 5 ed (1992) 272-284; S van der Merwe, LF van Huyssteen, MFB Reinecke & GF Lubbe *Contract – General Principles* 4 ed (2012) 469; DJ Joubert *General Principles of the Law of Contract* (1987) 286-293; ADJ van Rensburg, JG Lotz, TAR van Rhijn & RD Sharrock “Contract” in WA Joubert & JA Faris (eds) *The Law of South Africa* 9 3 ed (2014) para 433; R Zimmermann *The Law of Obligations: Roman Foundations of the Civilian Tradition* (1990) 760-761; RH Christie & GB Bradfield *Christie’s The Law of Contract in South Africa* 6 ed (2011) 494; *Joint Municipal Pension Fund (Transvaal) v Pretoria Municipal Pension Fund* 1969 2 SA 78 (T) 85C.

² Van der Merwe et al *Contract* 469.

³ 475.

⁴ LTC Harms “Obligations” in WA Joubert (ed) *The Law of South Africa* 19 2 ed (2006) para 243.

⁵ It has been described as a payment effected *brevi manu* (*Faatz v Estate Maiwald* 1933 SWA 73 87; *Joint Municipal Pension Fund (Transvaal) v Pretoria Municipal Pension Fund* 1969 2 SA 78 (T) 86A).

⁶ *Schierhout v Union Government (Minister of Justice)* 1926 AD 286 289.

⁷ *ABSA Bank Ltd v Standard Bank of SA Ltd* 1998 1 SA 242 (SCA) 251: “When a customer pays a cash amount equal to the debit balance of his overdrawn account into that account, there is no question of set-off operating. He simply pays the amount owing to the bank.”

⁸ Van der Merwe et al *Contract* 469.

⁹ See n 1 above.

¹⁰ Although a bank may appropriate money from a bank account by relying on its right to set-off (see ch 5 (5.2.2)), it can be argued that this is an accounting entry rather than a transfer of money.

¹¹ De Wet & Van Wyk *Kontraktereg* 1 272

however, lies in determining how and when set-off will operate. As we shall see, the principles surrounding the operation of set-off are fraught with problems and De Wet describes it as “een van die ingewikkeldste gebiede van die verbintenisreg hier by ons.”¹²

To a large extent, these problems can be attributed to the fact that, despite the general acceptance and use of set-off, its exact nature remains uncertain.¹³ It has been described as “either the automatic extinction of debts by operation of law on grounds of policy, or a juristic act whereby one party effects the extinction of debt by means of a unilateral juristic act.”¹⁴ These alternative descriptions stem from the fact that there is no general agreement about how and when set-off will operate: does it operate automatically by operation of law or only retrospectively, once a party seeks to rely on it?

The uncertainty which exists in this regard often results in contradictory statements in case law. An example of this is the following *dictum* by Lichtenberg J, where he states that:

“it is trite law that set-off operates automatically and that, once set-off is claimed or relied on, it relates back to the time when the two respective debts were mutually in existence. However, if a party to an action wants to obtain the benefit of set-off, he must claim to be entitled to set-off.”¹⁵

Another example is the statement by Hefer JA that

“[a]lthough set-off occurs automatically by operation of law, it only operates retrospectively if and when the debtor ... elects to rely on it.”¹⁶

These statements acknowledge the automatic operation of set-off, but still make the operation of set-off dependant on a decision by one of the parties to invoke it by stating

¹² “One of the most complex areas of our law of obligations” (own translation) – De Wet & Van Wyk *Kontraktereg* 1 272.

¹³ Van der Merwe et al *Contract* 469.

¹⁴ Van der Merwe et al *Contract* 469. Harms “Obligations” in *LAWSA* 19 para 243 describes it as one debt being cancelled by another, but see the criticism levelled against this view by Van der Merwe et al *Contract* 469.

¹⁵ *Herrigel NO v Bon Roads Construction Co (Pty) Ltd* 1980 4 SA 669 (SWA) 676.

¹⁶ *Standard Bank of South Africa Ltd v Echo Petroleum CC* 2012 5 SA 283 (SCA) para 33. Also see the discussion of this statement in ch 3 (3 4 3 4).

that “*if* a party ... *wants* to obtain the benefit of set-off”¹⁷ or “*elects* to rely on it”.¹⁸ The apparent contradiction stems from the tension between the notion that set-off should operate automatically and the value of contractual autonomy. These conflicting considerations lie at the core of the main question regarding the *ipso iure* operation of set-off, namely whether set-off should operate irrespective of the wishes of the parties.¹⁹

Before evaluating the two approaches to the operation of set-off, it is necessary to determine whether they render a different practical result, or whether, as averred by Christie and Bradfield, the debate surrounding the two opposing views to the operation of set-off is “something of a storm in a teacup”.²⁰ This will be done in greater detail in chapter 3,²¹ but it may be mentioned here that there are at least two scenarios where these approaches to set-off result in different practical outcomes.

The first is where A and B are jointly and severally liable to C, but A also has a counterclaim against C. If C attempts to collect the debt from B, the latter may not declare set-off in terms of the retrospective approach, but if the *ipso iure* approach is followed B should be able to rely on the automatic operation of set-off between A and C.²²

The second example is provided by Loots and Van Warmelo.²³ A owes an unenforceable gambling debt²⁴ to B, but B is also indebted to A. B pays his debt towards A after the requirements for set-off were met.²⁵ B now wants to enforce the debt owed to him by A.²⁶ Because B's original claim is unenforceable, he would have

¹⁷ Own emphasis.

¹⁸ Own emphasis.

¹⁹ Joubert *Law of Contract* 286.

²⁰ *Law of Contract* 494.

²¹ See ch 3 (3 4 2).

²² See ch 3 (3 4 2 1).

²³ JH Loots & P Van Warmelo “Compensatio” (1956) 19 *THRHR* 267 267.

²⁴ This will not include a legal gambling debt in terms of the National Gambling Act 7 of 2004, which will be enforceable.

²⁵ It is not entirely clear whether set-off can operate in respect of unenforceable wagers, but the courts seem to favour the view that it should be allowed (see Van der Merwe et al *Contract* 182 n 148; *Fensham v Jacobson* 1951 2 SA 136 (T); *Allison v Massel & Massel* 1954 4 SA 569 (T); *Rosen v Wasserman* 1984 1 SA 808 (W)). For an opposing view, see *Gibson v Van der Walt* 1952 1 SA 262 (A)). Also see ch 3 (3 2 n 37).

²⁶ See ch 3 (3 4 2 4) for a discussion on the status of payments made after the debt is susceptible to set-off.

to consider another basis for his claim against A. If B can prove that, in terms of the *ipso iure* approach, set-off operated automatically before he paid his debt, the debt would have been extinguished before payment was made. Any payment made by B would thus constitute an undue payment and B would be able to reclaim his payment with the *condictio indebiti*, provided all the requirements for that remedy are met. However, if the retrospective approach is followed, it is no longer possible to declare set-off, because one of the debts has ceased to exist by virtue of B's payment.²⁷ B's only cause of action will therefore be the original (unenforceable) debt. In this scenario, the approach to set-off which is followed will determine whether B has an enforceable claim in terms of unjustified enrichment or whether he has to rely (fruitlessly) on his original unenforceable claim.²⁸

De Wet and Van Wyk further point out that adopting one approach rather than the other will have an impact on the requirements for set-off to operate.²⁹ More specifically, the approach which is followed will be crucial in determining whether both debts need to be liquidated and enforceable before set-off can take place.³⁰ In other words, rather than being a "storm in a teacup", a particular approach to set-off not only has practical implications but it also determines when the debts will be susceptible to set-off.

Furthermore, the approach to set-off that is adopted will affect the principles relating to the exclusion of a party's right to rely on set-off, whether by way of agreement, waiver or estoppel.³¹ For instance, if it is accepted that set-off automatically occurs on the date that the debts become susceptible to its operation, it is questionable whether a party should be allowed to waive his right to rely on set-off after such date. The principles regarding the circumstances where a party will be precluded from relying on this form of debt-extinction are not clearly defined, which adds to the uncertainty surrounding the operation of set-off.

A last aspect of set-off which requires clarification is the extent to which the right of credit providers to rely on set-off is restricted in terms of sections 90 and 124 of the

²⁷ See ch 3 (3 4 1), where it is explained that, despite the retrospective effect attributed to a declaration of set-off, it is no longer possible to declare set-off if the debt has ceased to exist due to payment.

²⁸ Loots & Van Warmelo 1956 *THRHR* 267.

²⁹ De Wet & Van Wyk *Kontraktereg* 1 273-281.

³⁰ See ch 3 (3 2).

³¹ See ch 4.

National Credit Act 24 of 2005 (NCA). In terms of these provisions, a clause in a credit agreement which authorises the credit provider to appropriate money from an account of a debtor to satisfy an obligation in terms of a credit agreement must comply with certain requirements. This will clearly affect the right of a bank, operating as a credit provider, to rely on set-off by utilising funds from a client's transactional account towards repayment of that client's loan.

However, the extent to which this right is affected is uncertain. The relevant sections seem to indicate that the prescribed conditions only relate to a provision in a credit agreement that authorises a charge against an account (and therefore set-off).³² If this interpretation is correct, it would mean that, in order to circumvent a restriction of its right to invoke set-off, a credit provider has to refrain from stipulating the right in the credit agreement. Whether this interpretation is in line with the spirit and purposes of the NCA warrants investigation. It must further be determined whether any restriction on the right of a credit provider to invoke set-off is justified, and what the extent of such a restriction should be.

1 2 Purpose of the thesis, research questions and methodology

Although the following observation was made in the American context, one can argue that also in South Africa

“[s]etoff is ... a valuable commercial tool – a tool which should be standardized to avoid frustrating the reasonable expectations of those who deal in the fast-paced, modern world of ... commerce.”³³

Set-off features perhaps most prominently in the banking sector,³⁴ and that sector “has been particularly attracted by the virtues of simplification, efficiency, and security inherent in the idea of set-off.”³⁵ To understand why set-off plays such an important

³² This is the interpretation supported by the banks – see ch 5 (5 2 4).

³³ SL Sepinuck “The Problems with Setoff: A Proposed Legislative Solution” (1988) 30 *Wm. & Mary Law Review* 58.

³⁴ R Zimmermann *Comparative Foundations of the European Law of Set-Off and Prescription* (2002) 22.

³⁵ C Fountoulakis *Set-Off Defences in International Commercial Arbitration: A Comparative Analysis* (2011) 12.

role in modern society as a method of debt settlement,³⁶ it is necessary to identify its various functions.

Set-off primarily functions as a convenient method of effecting performance;³⁷ it is unnecessary for one party to pay the other, only to have the same performance returned.³⁸ Set-off thus avoids circuitry of performance, and enhances efficiency³⁹ by facilitating the speedy settlement of debts and eliminating the need for costly duplication of performance.⁴⁰

Set-off also performs a security function,⁴¹ by allowing the creditor to enforce fulfilment of the debtor's obligations, even in circumstances where such fulfilment would otherwise be difficult or even impossible to enforce. This function of set-off is perhaps most evident where one party becomes insolvent.⁴² In such circumstances a creditor of the insolvent who was able to invoke set-off before *concursum creditorum*, is allowed to rely on set-off,⁴³ provided such set-off meets the requirements of section 46 of the Insolvency Act 24 of 1936.⁴⁴ The notion of set-off providing security upon insolvency has been criticised by various authors, since it contravenes the *pari passu* principle.⁴⁵ As Pichonnaz states, "this [security] function is not an intrinsic aim of set-off but rather a remnant of its historical evolution."⁴⁶ The operation of set-off in cases of insolvency

³⁶ S Scott "Skuldvergelyking – Toe (ex tunc) en Nou (ex nunc)" 2006 TSAR 595 959; PR Wood *English and International Set-Off* (1989) vii.

³⁷ Fountoulakis *Set-Off Defences* 9. Voet explains that the origin of set-off or *compensatio* comes from the ancient custom of weighing up bronze, where "an equal amount of bronze which was due on either side ceased, when weighed together, to be due on either side, and only that which because of its preponderance was not weighed together remained in credit on the one side." (J Voet *Commentarius ad Pandectas* 16 2 1 tr P Gane *The Selective Voet being the Commentary on the Pandects by Johannes Voet and the Supplement to that Work by Johannes van der Linden* 3 (1956) 148).

³⁸ Joubert *Law of Contract* 286.

³⁹ Fountoulakis *Set-off Defences* 1; P Pichonnaz "Set-Off" in S Vogenauer (ed) *Commentary on the UNIDROIT Principles of International Commercial Contracts (PICC)* 2 ed (2005) 1033 1035, 1036.

⁴⁰ Van der Merwe et al *Contract* 469-470.

⁴¹ Fountoulakis *Set-Off Defences* 1-2, 11; C Jauffret-Spinozi "UNIDROIT 2000 Study L – Doc 62 bis: Position Paper" (2000) UNIDROIT 1 <<http://www.unidroit.org/english/documents/2000/study50/s-50-062bis-e.pdf>> (accessed 30-11-2015); Pichonnaz "Set-Off" in *UNIDROIT Principles* 1036.

⁴² Van der Merwe et al *Contract* 470.

⁴³ *Siltek Holdings (Pty) Ltd (in liquidation) t/a Workgroup v Business Connexion* 2009 1 All SA 571 (SCA); Christie & Bradfield *Law of Contract* 497.

⁴⁴ See ch 3 (3 4 2 3 n 135) for the wording of this section.

⁴⁵ Pichonnaz "Set-Off" in *UNIDROIT Principles* 164; R Derham *The Law of Set-Off* 3 ed (2003) 245-246; Zimmermann *European Law of Set-Off* 44.

⁴⁶ "Set-Off" in *UNIDROIT Principles* 1036.

is discussed in more detail later,⁴⁷ where it is argued that the role of set-off in this context should depend on the relevant policy considerations in the law of insolvency, rather than on the principles of set-off.

Finally, as Voet recognised, set-off rests on the “highest equity”.⁴⁸ Set-off thus plays a role in ensuring a fair outcome.⁴⁹ According to Fountoulakis, there are three ways in which set-off ensures fairness.⁵⁰ First, set-off provides a defence to a debtor against a claim from his creditor while the debtor has a counterclaim against the creditor. In other words, it is seen as unfair for the creditor to demand payment from the debtor where the former also owes certain amounts to the debtor.⁵¹ Secondly, it enables the creditor to enforce an obligation which is due, but which the debtor is unable or unwilling to fulfil.⁵² It is thus a reliable method of debt collection. A third manner in which set-off ensures an equitable outcome is where a debtor does not have the financial means to effect payment of his debt, but can fulfil his obligations towards the creditor by way of set-off.⁵³ In that way, set-off prevents the debtor from defaulting on his payment obligations and thus suffering the consequences of breach, such as cancellation of the contract or the invocation of an acceleration clause.

The functions fulfilled by set-off illustrate why it is an important tool used by large corporations and small businessmen alike, and “is of very considerable practical significance, on both a national and an international level.”⁵⁴ As mentioned above, it is a widely accepted method used in the banking industry to collect payment on loans, and it is important for both banks and their customers to have clarity about the principles surrounding the application of set-off. Failure to achieve certainty regarding the operation of set-off may defeat its purpose as an efficient and equitable remedy that eliminates unnecessary delays and litigation costs.

Thus, this dissertation addresses the areas of uncertainty surrounding set-off, as briefly set out above. The questions which will be investigated, and which serve as the focal

⁴⁷ See ch 3 (3 4 2 3 & 3 8); ch 6 (6 3 1).

⁴⁸ Voet *Commentarius ad Pandectas* 16 2 1 tr Gane *The Selective Voet* 3 148.

⁴⁹ Jauffret-Spinosi “UNIDROIT 2000 Study L – Doc 62 bis: Position Paper” *UNIDROIT* 1.

⁵⁰ *Set-Off Defences* 11.

⁵¹ 10.

⁵² 11.

⁵³ 11.

⁵⁴ Zimmermann *European Law of Set-Off* 22.

points of the chapters of this thesis,⁵⁵ are the following: (i) how did the principles regarding the operation of set-off develop;⁵⁶ (ii) what is the exact nature of set-off and how should it operate in modern South African society;⁵⁷ (iii) can the right to rely on set-off be excluded and if so, how;⁵⁸ and (iv) how is the operation of set-off affected by the NCA?⁵⁹

The problems experienced with regards to certain aspects of set-off are not limited to South African law. An analysis of these aspects can benefit greatly from adopting a comparative perspective. Therefore, certain civilian jurisdictions, which share a similar historical background with South Africa in respect of the development of set-off, will be considered to evaluate its nature and operation. Analysing the approaches recommended by the PICC⁶⁰ and the PECL⁶¹ can also be highly beneficial. In formulating these approaches, the respective committees responsible for drafting the provisions relating to set-off engaged in both an historical and a comparative analysis of the approaches to set-off adopted in civilian jurisdictions. Perhaps more importantly, they also considered the application of set-off in modern society. An investigation of the reasons leading to the recommendation of a specific approach by these committees may thus be of assistance in determining whether the South African approaches to set-off are outdated and whether there is a need for reform.

In evaluating the origin and purpose of sections 90 and 124 of the NCA, the dissertation examines the following: (i) the reports and policy documents prepared during the drafting of the NCA; (ii) the objectives of the NCA; and (iii) the jurisdictions considered in drafting the NCA. These considerations can also be instructive in suggesting the extent to which statutory restrictions on a credit provider's right to invoke set-off is desirable.

⁵⁵ Also see the more detailed chapter analysis at 1.4 below.

⁵⁶ Ch 2.

⁵⁷ Ch 3.

⁵⁸ Ch 4.

⁵⁹ Ch 5.

⁶⁰ Art 8. Also see Pichonnaz "Set-Off" in *UNIDROIT Principles* 1035-1075.

⁶¹ Art 13:101-13:107. Also see O Lando, H Beale, A Prüm & R Zimmermann (eds) *The Principles of European Contract Law: Part III* (2003) 139-155.

1 3 Limitation of the study

The purpose of this dissertation is to analyse the general principles relating to set-off. Therefore, it does not contain an in-depth discussion of the rules regarding set-off in insolvency.⁶² Whether set-off invoked by a creditor of an insolvent will be effective and binding depends upon the specific rules prescribed by the law of insolvency, and specifically section 46 of the Insolvency Act 24 of 1936.⁶³ This dissertation only considers the operation of set-off within the context of insolvency to the extent that its application in this area will be impacted by adopting a specific approach to set-off.⁶⁴

1 4 Chapter analysis

The thesis is structured as follows. Chapter 2 deals with the development of set-off in Roman and Roman-Dutch law and discusses how these developments have influenced the operation of set-off in South African law. In particular, it focuses on the origin of the dispute regarding the manner in which set-off operates and considers whether the different approaches to the operation of set-off might be based on a misinterpretation of Justinian's decrees.

Chapter 3 sets out the requirements for set-off, and further analyses the nature of set-off, paying particular attention to the question whether it operates automatically or whether a party must raise it before it is applicable. The practical effect of these approaches and the policy considerations informing them are also examined. Furthermore, this chapter investigates the approaches adopted in civilian jurisdictions in an attempt to determine whether they offer possible solutions to the current problems surrounding the operation of set-off in South African law.

Chapter 4 considers the circumstances in which a party will be precluded from relying on set-off. It focuses on an agreement between the parties to exclude set-off, waiver of a party's right to invoke set-off and the circumstances in which a party can be estopped from invoking his right to set-off. It highlights the uncertainties which exist

⁶² Much has been written internationally on this topic: see for instance W Johnston & T Werlen (eds) *Set-Off Law and Practice: An International Handbook* (2006), where each chapter (each dealing with a different jurisdiction) has a separate section dealing with set-off upon insolvency; Wood *Set-Off* ch 7; Derham *The Law of Set-Off* chs 6 & 8; Pichonnaz & Gullifer *Set-Off in Arbitration* chs 15 & 16.

⁶³ See ch 3 (3 4 2 3 n 135) for the wording of the section.

⁶⁴ See ch 3 (3 4 2 3).

regarding these exclusions, as well as the difficulty in reconciling the exclusion of set-off with the *ipso iure* approach to set-off.

The impact of sections 90 and 124 of the NCA on set-off is considered in chapter 5. The origin and purpose of these provisions, as well as the policy considerations informing them, are examined to establish whether and to what extent a limitation on a credit provider's right to invoke set-off is desirable.

Finally, chapter 6 offers suggestions for reform based on the possible solutions which become evident in the preceding chapters of the dissertation. It will be argued that, instead of focusing on the debate regarding the two opposing views to set-off, South African courts should take note of international developments and opt for a solution which is more in line with modern commercial reality.

CHAPTER 2: THE HISTORICAL DEVELOPMENT OF SET-OFF

2 1 Introduction

The operation of set-off in modern South African law, as in most other legal systems that derive their rules relating to set-off from Roman law, is not without problems.¹ To a large extent, these difficulties can be attributed to a lack of clarity in Roman law,² or more specifically to what Zimmermann describes as “Justinian’s somewhat half-hearted attempts to consolidate the rules of classical Roman jurisprudence.”³ The uncertainty found in modern legal systems with regards to the operation of set-off, both here and abroad, may therefore be understood better by examining its origins and development.⁴ The fact that the South African and civilian legal systems share the same historical foundations regarding the operation of set-off also provides a basis for the comparative study of different modern legal systems.

This chapter will provide an overview of the development of set-off from its Roman law origins to the application of set-off in Roman-Dutch law. The principles applied in Roman-Dutch law were eventually adopted in South African law and form the basis of our understanding of the operation of set-off, as will become apparent in the next chapter. Criticism levelled by modern jurists against the interpretation of historical sources will also be considered.

2 2 *Compensatio* in classical Roman law

In classical Roman law, set-off or *compensatio* operated purely as a procedural mechanism,⁵ which meant that it could only operate in the context of judicial proceedings. There was also no rule providing for the general application of set-off.⁶

¹ JH Loots & P Van Warmelo “Compensatio” (1956) 19 *THRHR* 166 166; JC de Wet & AH van Wyk *Die Suid-Afrikaanse Kontraktereg en Handelsreg* 1 5 ed (1992) 272.

² Loots & Van Warmelo 1956 *THRHR* 166.

³ R Zimmermann *The Law of Obligations: Roman Foundations of the Civilian Tradition* (1990) 761; M Kaser *Römisches Privatrecht* 10 ed (1977) tr R Dannenbring *Roman Private Law* 3 ed (1980) 265.

⁴ Loots & Van Warmelo 1956 *THRHR* 166.

⁵ Kaser *Römisches Privatrecht* tr Dannenbring *Roman Private Law* 265; Zimmermann *Obligations* 761 n 100, with reference to G IV 61 sqq; *Inst* IV 6; R Zimmermann *Comparative Foundations of the European Law of Set-Off and Prescription* (2002) 24.

⁶ JAC Thomas *Textbook of Roman Law* (1976) 107.

According to the Institutes of Gaius,⁷ which provides the best source of the principles applicable in classical Roman law and the earliest surviving document discussing set-off,⁸ *compensatio* was initially only recognised in three specific instances, except where the parties reached an agreement regarding set-off.⁹ These were *bonae fidei* actions, actions by bankers and actions by the purchaser of an insolvent estate (*bonorum emptor*). Each of these actions had its own requirements, although they all required that the claims existed between the same persons.¹⁰

2 2 1 *Bonae fidei iudicia*

In *bonae fidei* actions, the judge was tasked with determining what was due to the plaintiff *ex fide bona*.¹¹ The formula used by the plaintiff in these types of actions included a specific reference to good faith, which resulted in the judge having some discretion to decide what the defendant owed.¹² Because it was not fair for the defendant to be held liable for more than the balance owing from a transaction, the judge could take into account counterclaims that arose from the same transaction,¹³ and reduce the amount awarded to the plaintiff accordingly.¹⁴ *Compensatio* in this instance was a natural consequence of *bona fidei* actions¹⁵ rather than a form of set-off created by an emperor or legislator with specific policy considerations in mind.

The judge was, however, not obliged to deduct the counterclaim, and whether or not he did so was left entirely to his discretion.¹⁶ Therefore, set-off in these cases did not occur automatically¹⁷ and could not be said to have taken place *ipso iure* (automatically

⁷ See G IV 61-68 tr E Poste *Gaii Institutionum Iuris Civilis Commentarii Quattuor* or *Elements of Roman Law by Gaius* 3 ed (1890) 445-447.

⁸ C Fountoulakis *Set-Off Defences in International Commercial Arbitration: A Comparative Analysis* (2011) 27; ME Tigar "Automatic Extinction of Cross-Demands: *Compensatio* from Rome to California" (1965) 53 *Calif L Rev* 229.

⁹ See 2 2 2 3 below.

¹⁰ D 16 2 9, D 16 2 23; P Pichonnaz "The Retroactive Effect of Set-Off (*Compensatio*): A Journey through Roman Law to the New Dutch Civil Code" 2000 *TR* 541 559, with reference to Gordian C 4 31 9.

¹¹ Thomas *Roman Law* 108.

¹² D Johnston *Roman Law in Context* (1999) 116.

¹³ G IV 61; Fountoulakis *Set-Off Defences* 10, 26-27.

¹⁴ G IV 61.

¹⁵ RW Leage & CH Ziegler *Roman Private Law* 2 ed (1948) 427; R Sohm *Institutionen: Geschichte und System des römischen Privatrechts* 12 ed (1905) tr JC Ledlie *The Institutes: A Textbook of the History and System of Roman Private Law* 3 ed (1907) 441; Fountoulakis *Set-Off Defences* 27.

¹⁶ G IV 63; Fountoulakis *Set-Off Defences* 27.

¹⁷ Loots & Van Warmelo 1956 *THRHR* 167.

by operation of law without requiring any action by the defendant). If the judge refused to take the claim of the defendant into account, the defendant was allowed to sue thereon in a separate action.¹⁸ From this it can be deduced that where the defendant failed to raise set-off as a defence for consideration by the judge, he did not lose his original claim and retained the right to enforce it. This provides a further indication that the debts were not reduced automatically, but only where the defendant raised (and the judge allowed) *compensatio* as a defence.

Compensatio in this form was quite limited: it was only available in *bonae fidei* actions, it could only be effected by the judge or praetor if he decided to do so, and only counterclaims arising from the same transaction could be raised.¹⁹ Furthermore, although it was not specifically stated by Gaius, a reasonable inference can be drawn that the debts had to be due and enforceable,²⁰ although it is uncertain whether the debts had to be of the same kind.²¹

2 2 2 *Actiones stricti iuris*

Thus far, the focus was on actions governed by good faith. These actions stood in contrast to *actiones stricti iuris*, where the judge enjoyed no discretion to adjudicate according to the standard of good faith. Thus, in the context of *stricti iuris* actions, the judge generally had no opportunity to consider the possibility of set-off.²² However, in certain circumstances *compensatio* could be relied on in such actions. These situations were limited to the two exceptions mentioned below (i.e. actions by bankers and actions by purchasers of insolvent estates),²³ an agreement between the parties to reduce their claims²⁴ or where the *exceptio doli* was used.

¹⁸ Loots & Van Warmelo 1956 *THRHR* 168, citing Solazzi *La compensazione nel diritto romano* (1950) 22 sq.

¹⁹ Zimmermann *Obligations* 762; Kaser *Römisches Privatrecht* tr Dannenbring *Roman Private Law* 265.

²⁰ Loots & Van Warmelo 1956 *THRHR* 167.

²¹ Some authors are of the opinion that the debts had to be of the same kind and easily ascertainable (P van Warmelo *An Introduction to the Principles of Roman Civil Law* (1976) 239; Loots & Van Warmelo 1956 *THRHR* 167), whereas others state that it was not required that the performance owed had to be of the same kind and nature (Zimmermann *Obligations* 762).

²² Zimmermann *Obligations* 762.

²³ G IV 61-68; Thomas *Roman Law* 108.

²⁴ Zimmermann *Obligations* 762; Kaser *Römisches Privatrecht* tr Dannenbring *Roman Private Law* 265.

2 2 2 1 Actions by bankers (*argentarii*)

The first exception where set-off was allowed in *stricti iuris* actions, was in the case of an action instituted by a banker (*argentarius*) against his client. The relationship between a client and his banker was characterised by a number of transactions performed with or on behalf of each other, each of which constituted a separate cause of action.²⁵ For example: the client deposited 100 sestericii with his banker; the banker paid 60 sestericii to the client, and the banker thereafter paid 80 sestericii to a third party pursuant to an instruction by the client. In so far as the payment of the 60 sestericii did not constitute a *solutio* or repayment of the debt, these constituted three separate legal actions: the client had a claim of 100 against the banker under the original loan, and the banker usually had two separate claims of 60 and 80 each against the client.

However, in Roman law a banker was only allowed to sue his client for the net balance of the client's account.²⁶ To use the example above, the banker was compelled to take into account the 100 sestericii deposited by the client, as well as his payment to the client of 60 sestericii. He could therefore only claim 40 sestericii from the client, which was the difference between the 80 sestericii he advanced on the client's behalf and the remaining 40 sestericii he still owed the client. If the banker claimed more than the balance, he was guilty of *pluris petitio*,²⁷ which was a penalty that was imposed where the plaintiff claimed an amount in excess of the amount to which he was entitled.²⁸ In such a case, the consequences were drastic: the judge could refuse the banker's entire action and he would lose any future action based on that claim, even if he only over-claimed by an insignificant amount (e.g. 41 sestericii instead of 40).²⁹

The potential quantity of transactions involved in this type of relationship meant that it was clearly desirable to acknowledge *compensatio* in order to prevent a multiplication of claims.³⁰ However, this form of *compensatio* only took place where the banker instituted action, and not where the client claimed from the banker.³¹ The rationale

²⁵ Loots & Van Warmelo 1956 *THRHR* 168-169.

²⁶ G IV 64.

²⁷ Zimmermann *Obligations* 765.

²⁸ See G IV 53-60.

²⁹ G IV 68; Kaser *Römisches Privatrecht* tr Dannenbring *Roman Private Law* 265.

³⁰ Loots & Van Warmelo 1956 *THRHR* 169.

³¹ 170.

behind compelling the banker to effect *compensatio* and the dire consequences imposed on him if he failed to do so, was that the banker was the one responsible for bookkeeping,³² whereas it was unlikely that the client possessed the necessary accounting skills to record the transactions.³³

This type of *compensatio* was confined to claims of the same kind³⁴ and the banker only had to take account of debts that were already due.³⁵ Set-off was prescribed by law – it occurred *ipso iure*³⁶ and did not depend on the discretion of a judge.³⁷ There are however questions regarding the time set-off took effect and the extent to which it took place automatically. For example, it is unclear what effect *compensatio* had on the running of interest and whether the client could be held liable for penalties due to late payment in circumstances where set-off could have operated.

2 2 2 2 *Actions by purchasers of insolvent estates*

The second exceptional instance of *compensatio* in the context of *stricti iuris actiones* in classical law operated in the context of a *bonorum emptor* who bought the estate of an insolvent (*defraudator*). Where a person was unable to fulfil his obligations, his assets were sold as a unity to a buyer (*bonorum emptor*).³⁸ In return for receiving these assets, the buyer undertook to pay a dividend to creditors of the insolvent estate.³⁹

The assets forming part of the insolvent estate and sold to the *bonorum emptor* might have included claims against debtors of the estate. The *bonorum emptor* was allowed to institute action to collect these claims. However, if one of the debtors was also a creditor of the insolvent estate, the *bonorum emptor* could only claim from such a debtor the balance of the amount owed by the debtor to the estate.⁴⁰ In other words, where a debtor of the insolvent estate had a counterclaim against the estate, the debtor

³² 170.

³³ Thomas *Roman Law* 108.

³⁴ G IV 66.

³⁵ G IV 67.

³⁶ Zimmermann *Obligations* 764 n 114; Van Warmelo *Roman Civil Law* 239-240; Loots & Van Warmelo 1956 *THRHR* 168.

³⁷ Loots & Van Warmelo 1956 *THRHR* 170.

³⁸ 170.

³⁹ 170.

⁴⁰ G IV 65.

could insist that the amount claimed from him by the *bonorum emptor* be reduced by the amount of his counterclaim.⁴¹

As stated above, the purchaser of an insolvent estate was obliged to pay a dividend, for instance 70%, to all the creditors of an insolvent estate. For example, if the insolvent owed A 100 sestericii, A could only claim 70 sestericii from the *bonorum emptor*. However, some authors are of the opinion that a debtor who was simultaneously a creditor of the estate, could set off the full amount of his claim.⁴² For example, if the *defraudator* (or *bonorum emptor* as his “successor”) had a claim of 300 sestericii against A, the latter could deduct the full 100 sestericii and only pay 200 sestericii to the *bonorum emptor*. This clearly benefited A, because if set-off did not operate in this context, the *defraudator* would have a claim of 300 sestericii against A, but A would only be entitled to 70 sestericii from the *bonorum emptor*. This benefit may provide a possible explanation for recognising *compensatio* in this context. Why a creditor would receive this form of protection is not certain, but perhaps it was regarded as unfair to expect a creditor to pay the full amount of his debt to the insolvent estate where he only received a percentage of the amount owed to him.

In this instance, even where the debt was of a different genus it had to be deducted.⁴³ To use the same example as Gaius, if the insolvent estate owed B corn or wine, the value thereof had to be deducted by the *bonorum emptor* if he instituted a claim against B for money owed to the insolvent estate.⁴⁴ Furthermore, a debt which was not yet due also had to be taken into account.⁴⁵ These two deviations from the principles applicable to the other forms of *compensatio* mentioned above further benefited the creditor of the insolvent estate, since it increased the number of debts which were susceptible to set-off.

The *bonorum emptor* was not held to the same strict rules as the banker however and where he sued for an amount in excess of the balance, he would not forfeit his entire

⁴¹ Loots & Van Warmelo 1956 *THRHR* 170-171.

⁴² 172.

⁴³ G IV 66.

⁴⁴ G IV 66.

⁴⁵ G IV 67.

claim.⁴⁶ The judge was tasked with determining and balancing the two claims,⁴⁷ similar to *bonae fidei* actions, with the important distinction that here it did not depend on his discretion.⁴⁸ The *compensatio* therefore did not take place *ipso iure*⁴⁹ (unlike the case of the banker), but once a counterclaim was proved, the judge was obliged to decrease the award by the amount of such a demand.⁵⁰

2 2 2 3 Agreement between the parties and the *exceptio doli*

Roman law allowed the parties to come to an agreement (which could be informal) to set their claims off against each other⁵¹ in the form of a *pactum* for release.⁵² In the absence of such an agreement (or the application of the exceptions referred to above), the parties had to sue each other in separate actions.⁵³

Initially, the stringent formula applied in *stricti iuris* actions did not allow for equitable considerations.⁵⁴ the judge only had to determine whether the claim contained in the formula was due or not.⁵⁵ The defendant was allowed to deny the existence of the claim, but could not plead a counterclaim.⁵⁶ However, these strict principles were later relaxed and the praetor could take *compensatio* into account.⁵⁷ This could only be done if the defendant had a counterclaim which was due and of the same kind as the claim of the plaintiff, and such a counterclaim became evident during the course of the proceedings before the praetor.⁵⁸ Another important requirement was that the counterclaim had to be certain as to its existence and its amount,⁵⁹ sometimes referred to as having to be 'liquidated'.⁶⁰ In those circumstances, the praetor could request the plaintiff to reduce his claim with the amount of the counterclaim.⁶¹ If the plaintiff refused

⁴⁶ G IV 68.

⁴⁷ Loots & Van Warmelo 1956 *THRHR* 171; Van Warmelo *Roman Civil Law* 240.

⁴⁸ Loots & Van Warmelo 1956 *THRHR* 171; Van Warmelo *Roman Civil Law* 240.

⁴⁹ Van Warmelo *Roman Civil Law* 240.

⁵⁰ 240.

⁵¹ Zimmermann *Obligations* 762; DH van Zyl *History and Principles of Roman Private Law* (1983) 357.

⁵² Kaser *Römisches Privatrecht* tr Dannenbring *Roman Private Law* 265.

⁵³ Zimmermann *Obligations* 762.

⁵⁴ Van Warmelo *Roman Civil Law* 151; Fountoulakis *Set-Off Defences* 28.

⁵⁵ Tigar 1965 *Calif L Rev* 227.

⁵⁶ Fountoulakis *Set-Off Defences* 25.

⁵⁷ Zimmermann *Obligations* 762-673.

⁵⁸ 762.

⁵⁹ Fountoulakis *Set-Off Defences* 28.

⁶⁰ 28.

⁶¹ Zimmermann *Obligations* 762.

in circumstances where either the counterclaim was undisputed or the defendant was able immediately to prove the existence and amount of his claim, the judge could deny the plaintiff's action.⁶² The reason for the denial was that condemnation in the full amount would not be fair and proper.⁶³

Difficulty arose where the praetor was uncertain about the defendant's counterclaim, or the claim was not liquidated, since the strict formula of *stricti iuris* actions did not provide an opportunity for the praetor to evaluate the counterclaim.⁶⁴ As a solution, shortly after the time of Gaius,⁶⁵ a special regulation by Marcus Aurelius made it possible for a debtor to raise a counterclaim in *stricti iuris* actions⁶⁶ through the use of the *exceptio doli*.⁶⁷ This meant that the defendant had the option to insert the exception in the formula⁶⁸ and effect *compensatio*, even in respect of a counterclaim which was not liquidated.⁶⁹ However, the defendant was not obliged to do so.⁷⁰ By introducing this exception, the Emperor discarded the requirement that the claims had to arise out of the same transaction,⁷¹ although the debts probably had to be of the same kind.⁷²

Compensatio in this instance was achieved through the intervention of a judge⁷³ after being raised as an exception, and therefore could not have been said to take place *ipso iure*. However, unlike *bonae fidei* actions, set-off did not depend on the discretion of the judge.⁷⁴

Exactly how this *compensatio* took place in the context of these *stricti iuris* actions is still somewhat uncertain.⁷⁵ The *exceptio doli* was a procedural defence which could be used where there was fraud underlying the establishment of a claim.⁷⁶ If fraud was

⁶² 762.

⁶³ Zimmermann *Obligations* 762; Fountoulakis *Set-Off Defences* 10.

⁶⁴ Zimmermann *Obligations* 763; Fountoulakis *Set-Off Defences* 28.

⁶⁵ Loots & Van Warmelo 1956 *THRHR* 172.

⁶⁶ Van Warmelo *Roman Civil Law* 240.

⁶⁷ *Inst* IV 6 30; C 14 31 4, 4 31 14; DJ Joubert *General Principles of the Law of Contract* (1987) 287; Zimmermann *Obligations* 763.

⁶⁸ Zimmermann *Obligations* 763.

⁶⁹ Fountoulakis *Set-Off Defences* 28.

⁷⁰ Van Warmelo *Roman Civil Law* 240.

⁷¹ Poste *Elements of Roman Law* 521-522; Tigar 1965 *Calif L Rev* 231.

⁷² JAC Thomas *The Institutes of Justinian* (1975) 297.

⁷³ Loots & Van Warmelo 1956 *THRHR* 173.

⁷⁴ Loots & Van Warmelo 1956 *THRHR* 175-176; Kaser *Römisches Privatrecht* tr Dannenbring *Roman Private Law* 266.

⁷⁵ Zimmermann *Obligations* 764; Loots & Van Warmelo 1956 *THRHR* 173.

⁷⁶ Loots & Van Warmelo 1956 *THRHR* 174.

proven by the defendant, the praetor would dismiss the plaintiff's claim.⁷⁷ The application of the *exceptio doli* in the context of *compensatio* was problematic in two ways. First, the *exceptio doli* normally required *mala fides*, which could not necessarily be said to be present where the plaintiff disputed the existence of a counterclaim.⁷⁸ Secondly, there was no middle ground. Either the plaintiff's claim was successful and the full amount awarded, or his entire claim was dismissed.⁷⁹ This would not have been a problem where the defendant's claim was in excess of the plaintiff's demand, for in such a case it made sense for the plaintiff's claim to be dismissed. For instance, if the defendant had a counterclaim of 200 against the plaintiff's claim of 100, it was justifiable for the plaintiff not to be awarded anything. However, it would have been unfair towards the plaintiff where the defendant's claim was a lot smaller than the plaintiff's claim.⁸⁰

Different theories regarding the operation of the *exceptio doli* in this context have been formulated.⁸¹ The theory that is most commonly accepted is that the plaintiff was asked to reduce his claim with the amount of the counterclaim.⁸² If he accepted, the praetor could award the amount of the reduced claim.⁸³ However, if he refused, he ran the risk of losing his whole claim instead of it just being reduced.⁸⁴ According to this theory, where the plaintiff refused to reduce his claim despite the fact that the existence of the defendant's counterclaim was proven, he was no longer acting *bona fide* and therefore it was not inequitable if the judge refused his claim and absolved the defendant.⁸⁵

The strict formal requirements for *compensatio* were later relaxed,⁸⁶ so that by relying on the *exceptio doli* the claim could be reduced.⁸⁷ Presumably the *exceptio doli* also

⁷⁷ 174.

⁷⁸ G IV 119.

⁷⁹ G IV 53-57; Zimmermann *Obligations* 763; Fountoulakis *Set-Off Defences* 25; Loots & Van Warmelo 1956 *THRHR* 174.

⁸⁰ Loots & Van Warmelo 1956 *THRHR* 174.

⁸¹ Loots & Van Warmelo 1956 *THRHR* 174; Zimmermann *Obligations* 764.

⁸² Kaser *Römisches Privatrecht* tr Dannenbring *Roman Private Law* 266; Zimmermann *Obligations* 762; Sohm *Institutionen* tr Ledlie *The Institutes* 442; Loots & Van Warmelo 1956 *THRHR* 174-175. An opposing theory is advanced by Tigar, who is of the opinion that the *exceptio doli* could be used to reduce the amount awarded (1965 *Calif L Rev* 231; Fountoulakis *Set-Off Defences* 28 n 33)

⁸³ Loots & Van Warmelo 1956 *THRHR* 175; Zimmermann *Obligations* 764.

⁸⁴ Loots & Van Warmelo 1956 *THRHR* 175; Zimmermann *Obligations* 764.

⁸⁵ Zimmermann *Obligations* 764.

⁸⁶ Loots & Van Warmelo 1956 *THRHR* 175.

⁸⁷ Sohm *Institutionen* tr Ledlie *The Institutes* 443.

later made it possible for set-off to operate in *bonae fidei iudicia* where the counterclaim was not based on the same *causa*.⁸⁸ These developments paved the way for Justinian to recognise a more generalised form of set-off.⁸⁹

It is clear that the classical Roman jurists failed to develop a “uniform, logical and systematic approach to the problem of set-off”.⁹⁰ In some instances the debts had to be of the same kind, in other situations it was not a requirement. For certain types of *compensatio* the obligations had to arise from the same transaction, whereas for other types of set-off this was not a requirement. Set-off could be said to take place *ipso iure* in certain instances, but at other times depended wholly on the discretion of the judge. Undeniably, a more standardised set of rules was desirable and the time for reform was ripe.

2 3 *Compensatio* in post-classical Roman law: Justinian’s decrees

In the post-classical period, the distinction between the different forms of *compensatio* started to disappear⁹¹ and a trend towards generalisation became apparent.⁹² This resulted in Justinian attempting to formulate a rule⁹³ allowing for set-off to take place by operation of law in all possible situations⁹⁴ where the claim was capable of immediate assessment⁹⁵ (regardless of whether it was an *iudicium stricti iuris* or *bonae fidei*),⁹⁶ and without leaving it to the discretion of the judge.⁹⁷ He stated that:

“A constitution of our own, however, has allowed more generally those set-offs which obviously arise so that, as a matter of law, they reduce claims...”⁹⁸

and elsewhere:

“We decree that set-offs shall take place by operation of law in all lawsuits, without making any distinction between real or personal actions.”⁹⁹

⁸⁸ Kaser *Römisches Privatrecht* tr Dannenbring *Roman Private Law* 266.

⁸⁹ Zimmermann *Obligations* 766.

⁹⁰ 765.

⁹¹ Loots & Van Warmelo 1956 *THRHR* 173, 176.

⁹² Zimmermann *Obligations* 766.

⁹³ De Wet & Van Wyk *Kontraktereg* 1 272.

⁹⁴ Sohm *Institutionen* tr Ledlie *The Institutes* 446.

⁹⁵ Thomas *Roman Law* 109.

⁹⁶ Loots & Van Warmelo 1956 *THRHR* 177.

⁹⁷ 176.

⁹⁸ *Inst* IV 6 30 tr JAC Thomas *The Institutes of Justinian* (1975) 288.

⁹⁹ C 4 31 14 tr SP Scott *The Civil Law VI* (1973) 77.

To a large extent, the procedure used in *bona fidei* actions was extended to all actions. The judge determined the amount to which the defendant was condemned, but in calculating the amount he had to take into account any liquid counterclaims and set-off no longer depended on his discretion.¹⁰⁰ Only the balance was regarded as the amount of the debt.¹⁰¹ Importantly, it was no longer required that the actions arose from the same cause,¹⁰² although the performances owed had to be of the same nature.¹⁰³

However, the meaning of the decrees by Justinian that set-off takes place *ipso iure* (i.e. by operation of law)¹⁰⁴ is so unclear, that since the Middle Ages different views have developed regarding the operation of set-off.¹⁰⁵ The ordinary meaning of the phrase in this context is that *compensatio* takes place automatically, without requiring any action by the parties or the judge.¹⁰⁶ Therefore “[b]oth claims [were] regarded as being satisfied without any intervention of either of the parties being necessary”¹⁰⁷ and were regarded as having been extinguished merely by having co-existed.¹⁰⁸

There is evidence supporting the abovementioned interpretation. For instance, it is stated in the *Digest*¹⁰⁹ that where a debtor has paid his debt in a situation where set-off could have operated, he could reclaim the monies paid with the *condictio indebiti* “as if what was not owing had been paid.”¹¹⁰ This seems to indicate that if a debt was susceptible to set-off, the debtor no longer owed that debt to the creditor, because it had been extinguished automatically. Justinian also indicated that interest will cease to accrue on a debt which is susceptible to *compensatio*,¹¹¹ which further supports the notion that the debt was no longer due if set-off could operate.

¹⁰⁰ *Inst* IV 6 39; Zimmermann *Obligations* 766; Kaser *Römisches Privatrecht* tr Dannenbring *Roman Private Law* 266.

¹⁰¹ Kaser *Römisches Privatrecht* tr Dannenbring *Roman Private Law* 266.

¹⁰² Zimmermann *Obligations* 766-767; Kaser *Römisches Privatrecht* tr Dannenbring *Roman Private Law* 266.

¹⁰³ Loots & Van Warmelo 1956 *THRHR* 181; Zimmermann *Obligations* 767.

¹⁰⁴ *Inst* IV 6 30; Thomas *Institutes* 297; Van Zyl *Roman Private Law* 357.

¹⁰⁵ De Wet & Van Wyk *Kontraktereg* 1 272-273.

¹⁰⁶ Loots & Van Warmelo 1956 *THRHR* 177.

¹⁰⁷ Zimmermann *Obligations* 767.

¹⁰⁸ Kaser *Römisches Privatrecht* tr Dannenbring *Roman Private Law* 266.

¹⁰⁹ *D* 16 2 10 1; *D* 12 6 30.

¹¹⁰ *D* 16 2 10 1 tr A Watson *The Digest of Justinian* 2 (1998) 9.

¹¹¹ *C* 4 31 5; *C* 4 31 4; *D* 16 2 11.

On the other hand, there are also texts which indicate that *compensatio* did not take place *ipso iure* in the sense described above. For instance, in his *Codex*, Justinian states that “set-off can be *pleaded*”.¹¹² Various other texts employ phrases such as “being ready to make set-off”,¹¹³ “allowing set-off”¹¹⁴, having the “option [to] ... demand set-off”¹¹⁵ or that “the judge ... shall order ... set-off”,¹¹⁶ none of which are in line with the automatic operation set-off. It can be argued that the use of the phrase “*ipso iure*” only meant that it was no longer necessary for set-off to be raised by way of an exception,¹¹⁷ although it still had to be pleaded before a judge.¹¹⁸ Another possible explanation is that “*ipso iure*” referred to the type of *compensatio* which a banker was required to effect in classical law,¹¹⁹ which was prescribed by law and was not effected by the judge.¹²⁰ It is therefore possible that Justinian only intended a form of set-off which was not dependent on a judge to become effective, and that he further attributed *ex nunc* effect to set-off.¹²¹

In the light of the above, it comes as no surprise that subsequent jurists have struggled to formulate a universally accepted theory of how Justinian’s set-off operated.

2 4 The subsequent interpretation of the post-classical Roman-law approach to set-off

2 4 1 The Glossators

The result of the uncertainty with regards to Justinian’s decrees was that as early as the time of the Glossators two views developed regarding the operation of set-off.¹²²

¹¹² C 4 31 14 1 tr Scott *Civil Law VI* 77 (own emphasis).

¹¹³ D 16 2 2 tr Watson *Digest* 9.

¹¹⁴ D 16 2 16; D 16 2 19; D 16 2 16 2.

¹¹⁵ D 27 4 1 4 tr Scott *Civil Law III* 154. See also C 5 44 2 1.

¹¹⁶ C 4 31 3 tr Scott *Civil Law VI* 75.

¹¹⁷ WW Buckland *The Main Institutions of Roman Private Law* (1931) 390; C Salkowski *Institutionen: Grundzüge des Systems und der Geschichte des römischen Privatrechts* (1886) tr EE Whitfield *Institutes and History of Roman Private Law with Catena of Texts* (2008) 706-707; Fountoulakis *Set-Off Defences* 31.

¹¹⁸ Loots & Van Warmelo 1956 *THRHR* 178.

¹¹⁹ See 2 2 2 1 below.

¹²⁰ R Zimmermann “Ius Commune and the Principles of European Contract Law - Contemporary Renewal of an Old Idea” in HL MacQueen & R Zimmermann (eds) *European Contract Law: Scots and South African Perspectives* (2006) 1 30, with reference to P Pichonnaz *La compensation: Analyse historique et comparative des modes de compenser non conventionnels* (2001) 260.

¹²¹ Zimmermann “Ius Commune” in *European Contract Law* 30.

¹²² Loots & Van Warmelo 1956 *THRHR* 178; Zimmermann *Obligations* 767: “ope exceptions or ipso iure?”; Zimmermann *European Law of Set-Off* 25.

One group (which included Marthinus Gosia) held that *compensatio* takes place automatically¹²³ and therefore no declaration is required. According to them, the judge was obliged to deduct a liquid counterclaim, regardless of whether the defendant raised set-off.¹²⁴ This position was later adopted by the French historical school,¹²⁵ and Pothier also understood *ipso iure* to mean that *compensatio* occurs automatically without any person having to do anything to bring it about.¹²⁶

The majority of Glossators (which included Azo)¹²⁷ recognised “automatic” set-off, but still required a declaration in court¹²⁸ in order to bring it to the attention to the judge so that he could take it into account.¹²⁹ They were of the opinion that *compensatio* is something on which a party must rely, after which it was effected by a judge,¹³⁰ although it not depend on the discretion of the judge.¹³¹ For them the declaration had no substantive effect but served merely as a notification that the debt had been extinguished automatically,¹³² therefore they held that the effect of the declaration was retrospective.¹³³ According to their argument, the phrase “*ipso iure*” indicated that *compensatio* occurred by operation of law and did not depend on a decision by any party or the discretion of the judge.¹³⁴ Nonetheless set-off took place judicially through intervention of a judge¹³⁵ and because the judge would otherwise not be aware of the existence of the counterclaim, practical considerations supported the requirement of a declaration.¹³⁶

¹²³ Loots & Van Warmelo 1956 *THRHR* 178-179; Pichonnaz 2000 *TR* 547.

¹²⁴ Fountoulakis *Set-Off Defences* 31.

¹²⁵ Pichonnaz 2000 *TR* 548.

¹²⁶ Loots & Van Warmelo 1956 *THRHR* 177-178, citing Pothier *Traité des obligations*, *iii^e partie, chap IV: De la compensation*. This influenced the drafters of the French Civil Code: art 1290 provides for automatic set-off (Loots & Van Warmelo 1956 *THRHR* 178 n 49; Zimmermann *European Law of Set-Off* 25. Also see ch 3 (3 5 1)).

¹²⁷ Pichonnaz 2000 *TR* 548.

¹²⁸ 547.

¹²⁹ 548.

¹³⁰ Loots & Van Warmelo 1956 *THRHR* 179.

¹³¹ H De Groot *Inleidinge* 3 40 6 tr AFS Maasdorp *The Introduction to Dutch Jurisprudence of Hugo Grotius with an Appendix Containing Selections from the Notes of William Schorer* (1903) 333-334; Loots & Van Warmelo 1956 *THRHR* 179.

¹³² Pichonnaz 2000 *TR* 548.

¹³³ Zimmermann *European Law of Set-Off* 26.

¹³⁴ Loots & Van Warmelo 1956 *THRHR* 179.

¹³⁵ 179.

¹³⁶ Pichonnaz 2000 *TR* 548.

2 4 2 The Roman-Dutch jurists

Two divergent approaches regarding the operation of set-off also developed in Roman-Dutch law.¹³⁷ The majority of Roman-Dutch writers followed the approach that set-off takes place *ipso iure*,¹³⁸ although they recognised that the defendant must raise the defence of *compensatio*¹³⁹ in order to bring it to the attention of the court.¹⁴⁰ Raising the defence of *compensatio* merely served as a notification that the debt had been extinguished¹⁴¹ and therefore, once raised, the operation of set-off would date back to the moment it first became possible.¹⁴² Accordingly, interest would no longer run on that part of the creditor's claim which became susceptible to set-off.¹⁴³ The debtor would also not be liable for a penalty or fine for late payment if he had the right to set-off at the time that payment became due.¹⁴⁴

¹³⁷ BvD van Niekerk "Some Thoughts on the Problem of Set-Off" (1968) 85 SALJ 36.

¹³⁸ De Groot *Inl* 3 40 7 tr Maasdorp *Introduction* 334; J Voet *Commentarius ad Pandectas* 16 2 1 tr P Gane *The Selective Voet being the Commentary on the Pandects by Johannes Voet and the Supplement to that Work by Johannes van der Linden* 3 (1956) 148; J Voet *Observationes ad Hugonis Grotii manudictionem* tr P Van Warmelo & C Visser *Aantekeninge oor die Inleiding van Hugo de Groot* 2 (1987) 264; U Huber *Heedensdaegse Rechtsgeleertheit* 3 41 8 tr P Gane *The Jurisprudence of my Time* 1 (1939) 598; SA Groenewegen *De Legibus Abrogatis* 4 31 4 1 tr B Beinart & ML Hewett *A Treatise on the Laws Abrogated and no longer in use in Holland and Neighbouring Regions by Simon A Groenewegen van der Made* 3 3 ed (1984) 191; S van der Merwe, LF van Huyssteen, MFB Reinecke & GF Lubbe *Contract – General Principles* 4 ed (2012) 473; Joubert *Law of Contract* 288.

¹³⁹ De Groot *Inl* 3 40 7 tr Maasdorp *Introduction* 334; Huber *HR* 3 41 8 tr Gane *The Jurisprudence of my Time* 1 598; Groenewegen *De Leg Abr* 4 31 4 1 tr Beinart & Hewett *Laws Abrogated* 3 191; Voet *Commentarius ad Pandectas* 16 2 2 tr Gane *The Selective Voet* 3 149-150; Voet *Observationes* tr Van Warmelo & Visser *Aantekeninge* 264; Van der Keessel *Praelectiones Iuris Hodierni ad Hugonis Grotii Intruductionem ad Iurisprudentiam Hollandicam* 3 40 7 tr P Van Warmelo, LI Coertze & HL Gonin *Voorlesinge oor die Hedendaagse Reg na Aanleiding van De Groot se "Inleiding tot De Hollandse Rechtsgeleerdheid"* 3 (1975) 429; Joubert *Law of Contract* 288; RW Lee *An Introduction to Roman-Dutch Law* 4 ed (1946) 275; De Wet & Van Wyk *Kontraktereg* 1 282.

¹⁴⁰ De Groot *Inl* 3 40 7 tr Maasdorp *Introduction* 334; Voet *Commentarius ad Pandectas* 16 2 2 tr Gane *The Selective Voet* 3 149-150; Van der Keessel *Praelectiones ad Gr* 3 40 7 tr Van Warmelo et al *Voorlesinge* 429; Lee *Roman-Dutch Law* 275; De Wet & Van Wyk *Kontraktereg* 1 282; LTC Harms "Obligations" in WA Joubert (ed) *The Law of South Africa* 19 2 ed (2006) para 245.

¹⁴¹ Voet *Commentarius ad Pandectas* 16 2 2 tr Gane *The Selective Voet* 3 149-150; Voet *Observationes* tr Van Warmelo & Visser *Aantekeninge* 265; Huber *HR* 3 41 8 tr Gane *The Jurisprudence of my Time* 1 598; Van der Keessel *Praelectiones ad Gr* 3 40 7 tr Van Warmelo et al *Voorlesinge* 429.

¹⁴² Huber *HR* 3 41 8 tr Gane *The Jurisprudence of my Time* 1 598; Voet *Commentarius ad Pandectas* 16 2 2 tr Gane *The Selective Voet* 3 149-150; Voet *Observationes* tr Van Warmelo & Visser *Aantekeninge* 265; Lee *Roman-Dutch Law* 276.

¹⁴³ Huber *HR* 3 41 8 tr Gane *The Jurisprudence of my Time* 1 598; Voet *Commentarius ad Pandectas* 16 2 2 tr Gane *The Selective Voet* 3 149; J Van der Linden *Koopmans Handboek* 1 18 4 tr H Juta *Institutes of Holland, or Manual of Law, Practice, and Mercantile Law* 3 ed (1897) 202-204; Van der Keessel *Praelectiones ad Gr* 3 40 7 tr Van Warmelo et al *Voorlesinge* 429.

¹⁴⁴ Voet *Commentarius ad Pandectas* 16 2 2 tr Gane *The Selective Voet* 3 149; De Groot *Inl* 3 40 7 tr Maasdorp *Introduction* 334.

Proponents of the abovementioned view held that where the defendant failed to raise his claim and paid the full amount, he could reclaim the amount paid as an *indebitum*.¹⁴⁵ This is a logical consequence of the fact that the debts were extinguished automatically: because the debt no longer existed, there was no legal ground for the payment. However, Voet¹⁴⁶ also stated that a debtor could choose whether he wanted to rely on set-off; if he chose instead to pay his debt, he retained his right to collect the original debt. This is clearly inconsistent with the automatic operation of set-off he supported.¹⁴⁷

Voet was further of the opinion that set-off depended on the utmost free will of the person raising it.¹⁴⁸ Therefore, a person who did not claim set-off when he could have done so was not regarded as having released his adversary.¹⁴⁹ However, according to Voet:

“Clearly if a person who has the capacity of set-off and is not unaware of it has neglected somewhat often to employ set-off, when he has no reasonable cause for having *wished rather that his credit should be preserved to him* than that it should be destroyed by set-off, an inference that the debt has in that case been foregone is not unreasonable.”¹⁵⁰

It is once again difficult to reconcile these statements by Voet with the *ipso iure* operation of set-off advocated by him, since it seems to indicate that the defendant had a choice whether or not set-off should operate.

There was also support for an opposing view, namely that a declaration by the parties was required for set-off to operate.¹⁵¹ However, such a declaration had a retrospective effect, which meant that the debts extinguished each other from the moment of their

¹⁴⁵ Voet *Commentarius ad Pandectas* 16 2 2 tr Gane *The Selective Voet* 3 150; Van der Linden *Koopmans Handboek* 1 18 4 tr Juta *Institutes of Holland* 202-204; Joubert *Law of Contract* 288; Loots & Van Warmelo 1956 *THRHR* 179.

¹⁴⁶ *Commentarius ad Pandectas* 16 2 2, 16 2 6 tr Gane *The Selective Voet* 3 150, 155-156; tr Van *Observationes* Warmelo & Visser *Aantekeninge* 265.

¹⁴⁷ De Wet & Van Wyk *Kontraktereg* 1 282.

¹⁴⁸ Voet *Observationes* tr Van Warmelo & Visser *Aantekeninge* 265.

¹⁴⁹ Voet *Commentarius ad Pandectas* 16 2 3 tr Gane *The Selective Voet* 3 151-152; Maasdorp *Introduction* 677.

¹⁵⁰ Voet *Commentarius ad Pandectas* 16 2 3 tr Gane *The Selective Voet* 3 151-152 (own emphasis).

¹⁵¹ De Wet & Van Wyk *Kontraktereg* 1 282 with reference to Van Leeuwen *Censura Forensis* 1 4 36 1 and *Rooms-Hollandsche Regt* 4 40 2; Zimmermann *Obligations* 761 (also with reference to Van Leeuwen).

mutual existence.¹⁵² Van Leeuwen required the declaration to take place by way of exception or defence,¹⁵³ and therefore in the course of legal proceedings.

It is clear that both these approaches required the intervention of a judge for set-off to become effective (although it did not depend on his discretion) – an informal out-of-court declaration was not accepted by either group. A possible reason for this is that acting without the intervention of a judge would amount to a form of “self-help”, which was forbidden.¹⁵⁴ However despite this, set-off was no longer merely a procedural remedy (which could only operate as the equivalent of a modern counterclaim), but rather a substantive right.¹⁵⁵ This meant that its “effects [were] produced independently from the rendering of a judgement”¹⁵⁶ and set-off could have a substantive effect, for instance to stop the running of interest, even before it had been raised in judicial proceedings. This also meant that if the debtor failed to raise *compensatio* as a defence, he was allowed to invoke it even after judgment.¹⁵⁷

In order to effect set-off, the debts must have subsisted between the same parties.¹⁵⁸ It was required that the counterclaim had to be of the same kind as the claim¹⁵⁹ and

¹⁵² See n 151 above.

¹⁵³ *RHR* 4 40 2 tr JG Kotzé *Simon van Leeuwen's Commentaries on Roman-Dutch Law 2 revised and edited by Decker CW* (1886) 329.

¹⁵⁴ Pichonnaz 2000 *TR* 549.

¹⁵⁵ See the discussion in P Pichonnaz “Set-Off *Compensatio*: From Diversity to Unity – Comments on the Principles of European Contract Law Part Three” in A Vaquer (ed) *The Principles of European Contract Law Part III* (2005) 281 282-284.

¹⁵⁶ 283.

¹⁵⁷ Huber *HR* 3 41 25 tr Gane *The Jurisprudence of my Time* 1 602; Voet *Commentarius ad Pandectas* 16 2 2 tr Gane *The Selective Voet* 3 150; Van der Keessel *Praelectiones ad Gr* 3 40 7 tr Van Warmelo et al *Voorlesinge* 429.

¹⁵⁸ De Groot *Inl* 3 40 6 tr Maasdorp *Introduction* 333-334; Maasdorp *Introduction* 678; Van der Linden *Koopmans Handboek* 1 18 4 1, 1 18 4 6 tr Juta *Institutes of Holland* 203-204. It was further accepted that the cessionary's claim could be reduced by the amount which was due to the debtor at the time of cession, since *compensatio* took place automatically when the debts were in existence (Huber *HR* 3 41 17 tr Gane *The Jurisprudence of my Time* 1 600-601; Voet *Commentarius ad Pandectas* 16 2 4 tr Gane *The Selective Voet* 3 152-153). This would be the case even where multiple cessions took place (Voet *Commentarius ad Pandectas* 16 2 5 tr Gane *The Selective Voet* 3 154).

¹⁵⁹ Huber *HR* 3 41 9 tr Gane *The Jurisprudence of my Time* 1 598-599; Voet *Commentarius ad Pandectas* 16 2 18 tr Gane *The Selective Voet* 3 169-170; De Groot *Inl* 3 40 9, 3 40 10 tr Maasdorp *Introduction* 334; Van der Linden *Koopmans Handboek* 1 18 4 1 tr Juta *Institutes of Holland* 203.

that it was both liquid¹⁶⁰ and due,¹⁶¹ although the debts did not need to arise from the same cause.¹⁶² Huber attributed the first two aspects, namely that the counterclaim had to be of the same kind and liquid, to what he called the “immediacy characteristic of set-off”,¹⁶³ since *compensatio* could not take place automatically by operation of law where a determination of values was required. Nonetheless, the question whether the debt was liquid largely depended on the discretion of the judge.¹⁶⁴

2 4 3 The Pandectists

It has been suggested that the German Pandectists gave new meaning to the declaration required to effect set-off,¹⁶⁵ and that under their influence, a shift took place in the importance of the declaration:¹⁶⁶ where it was first merely declaratory, the effect of the declaration then became constitutive, meaning that it was only possible to realise set-off by way of a declaration.¹⁶⁷ According to Pichonnaz, the development of the notion of retroactivity can be ascribed to this shift in the importance of the declaration, but he indicates that it is unclear why the effect of the declaration should be retroactive.¹⁶⁸

It is argued that the reason why the Pandectists attributed a retrospective effect to the declaration of set-off, was possibly due to their attempt to reconcile their theory with the two texts of the *Digest*.¹⁶⁹ The first text on which the Pandectists base their theory is *D* 16 2 10 1, which reads as follows:

¹⁶⁰ Huber *HR* 3 41 11 tr Gane *The Jurisprudence of my Time* 1 599; Voet *Commentarius ad Pandectas* 16 2 4, 16 2 17 tr Gane *The Selective Voet* 3 153, 168-169; De Groot *Inl* 3 40 8, 3 40 10 tr Maasdorp *Introduction* 334; Van der Linden *Koopmans Handboek* 1 18 4 3 tr Juta *Institutes of Holland* 203; Van der Keessel *Praelectiones ad Gr* 3 40 6, 3 40 8, 3 40 10 tr Van Warmelo et al *Voorlesinge* 427, 429.

¹⁶¹ Huber *HR* 3 41 13 tr Gane *The Jurisprudence of my Time* 1 599; Voet *Commentarius ad Pandectas* 16 2 4, 16 2 17 tr Gane *The Selective Voet* 3 153, 168-169; Van der Linden *Koopmans Handboek* 1 18 4 2 tr Juta *Institutes of Holland* 203.

¹⁶² Huber 3 41 13 tr Gane *The Jurisprudence of my Time* 1 599-600.

¹⁶³ *HR* 3 41 9 tr Gane *The Jurisprudence of my Time* 1 598-599.

¹⁶⁴ Loots & Van Warmelo 1956 *THRHR* 181, with reference to Van Leeuwen *Cens For* I IV 36 3 4.

¹⁶⁵ Pichonnaz 2000 *TR* 554.

¹⁶⁶ 554.

¹⁶⁷ 554.

¹⁶⁸ 554.

¹⁶⁹ 554.

“Accordingly, if someone who is able to make set-off pays, he can bring a *condictio* as if what was not owing has been paid.”¹⁷⁰

The second text which influenced the Pandectists is *D 16 2 11*:

“When one party owes the other money without interest and the latter owes money with interest, it has been decided in a *constitutio* by the deified Severus that the interest on the respective sums of both parties is not to be paid.”¹⁷¹

Both of these texts *prima facie* support either the *ipso iure* or retrospective operation of set-off. The first text seems to indicate that the debts had been discharged automatically by set-off at the moment that the requirements for set-off were fulfilled. Therefore, any payment made can be reclaimed with an enrichment action as nothing was due after that moment. The second text is along the same lines and seems to indicate that the running of interest is suspended from the moment that set-off could operate, because the debts are extinguished automatically. Neither of these texts appears to require a declaration of set-off in order for set-off to occur.

As discussed above,¹⁷² a similar effect was already acknowledged by Van Leeuwen. He also considered the declaration a prerequisite for set-off to operate and therefore, unlike the majority of Roman-Dutch jurists, attributed a substantive effect to the declaration of set-off. Presumably, his reasoning was based on the same texts which influenced the Pandectists.

2 4 4 Modern jurists

Thus far, this chapter has shown that the conflicting opinions on the operation of set-off may be traced back to the use of the phrase “*ipso iure*” in Justinian’s decrees. Just like the Glossators and Roman-Dutch jurists, modern writers have struggled to agree on a proper interpretation of Justinian’s decrees.¹⁷³ The dispute regarding the meaning

¹⁷⁰ Tr Watson *Digest* 9.

¹⁷¹ Tr Watson *Digest* 10. Why the text refers to interest “on the respective sums” where the first part indicates that interest is only owing on one of the debts is not clear. It does not seem to be a translation error, as Scott’s translation also states that “interest was not due on the sums owed to one another by the two parties respectively” (Scott *Civil Law II* 286).

¹⁷² See 2 4 2 above.

¹⁷³ Van Niekerk 1968 *SALJ* 36.

of the phrase “*ipso iure*” and whether or not a declaration was required to effect set-off under Justinian’s rule remains unsettled even in modern law.¹⁷⁴

It must be kept in mind that Justinian did nothing innovative by introducing the concept of *ipso iure compensatio* – he merely confirmed a previous practice which had developed in the late classical period.¹⁷⁵ Procedural requirements became less formal in post-classical times, and it was no longer necessary to invoke a special exception at the beginning of the proceedings, because the right to set-off was included in the action itself, *ipso iure*.¹⁷⁶ The phrase “*ipso iure*” was also not new, but was used by classical jurists.¹⁷⁷ Therefore by speaking of *compensatio ipso iure*, Justinian merely recognised this pre-existing principle and further stated that actions could be reduced if a counterclaim was raised.¹⁷⁸ One should therefore “not be unduly let astray by the term ‘*ipso iure*’”.¹⁷⁹

Arguably, those who interpret the *Digest* as providing for automatic set-off without requiring any form of declaration by the parties, fail to take into account all the texts of the *Digest*.¹⁸⁰ Van Niekerk states that viewed with some of the other texts of the *Digest*, “it is in fact difficult to comprehend how generations of later jurists could deduce from these texts an automatic extinction of a debt *pro tanto* by setting off without volition of the parties.”¹⁸¹ Such a view is for instance difficult to reconcile with *D* 16 2 2,¹⁸² which reads as follows:

“Anyone bars the claim of his creditor, who at the same time is his debtor, if he is ready to make set-off.”¹⁸³

This text envisages a choice on the part of the debtor to decide whether he wishes to invoke set-off, although such a choice is completely inconsistent with the view that set-off operates automatically.

¹⁷⁴ Zimmermann *Obligations* 761. See Chapter 3 for a full discussion.

¹⁷⁵ Pichonnaz 2000 *TR* 546. See also Zimmermann *Obligations* 766-767.

¹⁷⁶ Pichonnaz 2000 *TR* 546; Zimmermann *Obligations* 766-767.

¹⁷⁷ Pichonnaz 2000 *TR* 546 with reference to *D* 16 2 21, *D* 16 2 4 and *D* 16 10 23.

¹⁷⁸ Pichonnaz 2000 *TR* 546.

¹⁷⁹ Van Niekerk 1968 *SALJ* 31.

¹⁸⁰ Van Niekerk 1968 *SALJ* 32; Loots & Van Warmelo 1956 *THRHR* 178.

¹⁸¹ 1968 *SALJ* 32.

¹⁸² Also mentioned at 2 3 above.

¹⁸³ Translation Watson *Digest* 9.

Some leading authors in the field (especially in Europe)¹⁸⁴ have also raised doubts regarding the interpretation of Justinian's decrees by the earlier writers, such as the Pandectists and Roman-Dutch authors.¹⁸⁵ Two such authors are Pichonnaz and Zimmermann. Whereas Pichonnaz¹⁸⁶ places particular emphasis on the historical reasons why these views are "dogmatically inappropriate",¹⁸⁷ Zimmermann¹⁸⁸ focuses on practical and policy reasons to indicate why reform is desirable. These policy considerations will be discussed in a subsequent chapter,¹⁸⁹ but it would be beneficial to take cognisance of Pichonnaz's critique here.

Pichonnaz focuses on the development by the German Pandectists, and in particular the two texts he argues their views were based on (as discussed above).¹⁹⁰ He emphasises that is important to read both these texts in their proper context.

According to the *inscriptio*, the first of the abovementioned texts¹⁹¹ forms part of Ulpian's discussion regarding the selling of an insolvent estate.¹⁹² It therefore initially dealt with a very specific case, namely where a creditor of an insolvent estate who was simultaneously a debtor of the estate failed to invoke set-off.¹⁹³ It thus reflects the type of set-off applied by the *bonorum emptor*, as discussed above.¹⁹⁴ The reason behind the provision was to protect a creditor who was able to set the full amount of his claim off against the debt owing to the insolvent, but who, if he had to sue for payment, could only claim the percentage offered by the *bonorum emptor*.¹⁹⁵

This can be illustrated by using the same example as above.¹⁹⁶ Where the *bonorum emptor* paid a dividend of 70% and A had a claim of 100 sestericii against the *defraudator*, he would only receive 70 sestericii. However, if A also owed 300 sestericii to the insolvent estate, he could presumably deduct the entire 100 sestericii and therefore only had to repay 200 sestericii. But what happened where A failed to invoke

¹⁸⁴ Pichonnaz 2000 TR 544.

¹⁸⁵ See for instance Van Niekerk 1968 SALJ 31-33.

¹⁸⁶ 2000 TR 541-546.

¹⁸⁷ 541.

¹⁸⁸ See for instance *European Law of Set-Off* 22-60

¹⁸⁹ See ch 3 (specifically 3 6 to 3 8).

¹⁹⁰ See 2 4 3 above.

¹⁹¹ D 16 2 10 1.

¹⁹² Pichonnaz 2000 TR 555.

¹⁹³ 555.

¹⁹⁴ See 2 2 2 2 above.

¹⁹⁵ Pichonnaz 2000 TR 555.

¹⁹⁶ See 2 2 2 2 above.

set-off and paid the full 300 sestericii? Ordinarily A would be left with a claim of 70 sestericii. However, this statement by Ulpian meant that the part of the amount paid by A that was susceptible to set-off (i.e. 100 of the 300 sestericii) was seen as an undue payment. He was therefore allowed to reclaim the full 100 sestericii as if an amount which was not due was paid by him to the insolvent estate. In the absence of this decree, A would have had to rely on the insolvent's original indebtedness (in other words, his original claim instead of a claim for restitution of an undue payment) and would merely have been able to claim the reduced amount (i.e. 70 sestericii).

The second text,¹⁹⁷ attributed to Paul, according to the *inscriptio* possibly dealt with the case of a partnership (*societas*).¹⁹⁸ Pichonnaz argues that the only scenario to which it can apply is where one of the partners was guilty of abuse of the common funds in the partnership by not immediately returning profits obtained while acting on behalf of the *societas*.¹⁹⁹ Such a partner had to return the money with interest in order to compensate for the loss of profit. In the case of a *societas* with only two associates (such as contemplated in the text),²⁰⁰ the obligation to return the money to the partnership in effect amounted to giving the other partner half of the funds.²⁰¹ Therefore, if the other associate was equally indebted to the partnership, there was no longer an abuse of common funds.²⁰² Consequently, interest should cease to run on that part of the amount in respect of which both partners were equally indebted. For example, if partner A owed 100 sestericii to the partnership and partner B 150 sestericii, only the 50 sestericii by which B's debt exceeded that of A should bear interest. In such circumstances the reason for penalising the one partner and compensating the other fell away. The rationale for the interruption in interest was thus not due to the operation of set-off, but rather due to fact that the reason for penalising the one partner had ceased to exist.

In the light of the above, Pichonnaz argues that neither of these texts provides support for recognising a retroactive effect of set-off.²⁰³ He shows how two misunderstandings

¹⁹⁷ D 16 2 11.

¹⁹⁸ Pichonnaz 2000 TR 555.

¹⁹⁹ 557.

²⁰⁰ By use of the phrase "alter alteri" (Pichonnaz 2000 TR 557).

²⁰¹ Pichonnaz 2000 TR 557.

²⁰² 557.

²⁰³ 556, 558.

led to the development of this doctrine by the Pandectists: (a) they incorrectly extended the *ipso iure* effect of set-off beyond the very specific situation of claims made against an insolvent estate and (b) they relied on a text which had nothing to do with the operation of set-off in the first place. Based on this argument, Pichonnaz states that “the two main grounds of justification used by the Pandectists to base a retroactive effect on the Roman sources failed”.²⁰⁴

A third, more practical reason why the Pandectists ascribed a retrospective effect to the declaration of set-off, is the fact that it had to be pleaded in court.²⁰⁵ The Pandectists (like the Roman-Dutch writers) did not recognise an informal, out-of-court declaration. Therefore, in the absence of a retroactive effect, the creditor who had a larger claim could delay instituting action and thereby earn more interest.²⁰⁶ Of course, this justification disappears if the declaration may be made out of court.²⁰⁷

There is little doubt that the Roman-Dutch jurists (and in particular Van Leeuwen), formed their views based on the same misconceptions highlighted above. His view with regards to the effect of the declaration correlated with that of the Pandectists.²⁰⁸ This misconception was therefore invariably carried over to South African law and thus there may be scope to reconsider the manner in which set-off operates in modern South African law. This will be considered in the next chapter.

2 5 Conclusion

Justinian attempted to standardise and generalise the fragmented approach to set-off followed in Roman law. Instead, the uncertainty regarding his decrees led to divergent opinions with regard to the operation of set-off forming. Different approaches have developed as early as the time of the Glossators, but have evolved somewhat over the centuries. The Glossators were divided on whether set-off operated completely automatically, or automatically, but subject to a declaration in court. The Roman-Dutch writers and Pandectists realised the impracticality of attributing a completely automatic effect to set-off and required a declaration, although they disagreed on the effect of the declaration, i.e. whether it served merely as a notification that the debt had

²⁰⁴ 559.

²⁰⁵ 559.

²⁰⁶ 559.

²⁰⁷ 559.

²⁰⁸ See 2 4 2 and 2 4 3 above.

automatically been extinguished, or whether it had a substantive effect. It is possible, however, that both these groups were misled by a combination of an unfortunate use of phrase “*ipso iure*” and the context of certain texts being lost over time.

In the light of the above it is apparent that historical sources cannot provide a conclusive answer to the question of how set-off should operate.²⁰⁹ However, as Pichonnaz also admits,²¹⁰ merely because current approaches to the operation of set-off are based on an incorrect analysis of the Roman sources does not in itself provide a good enough justification for suggesting an amendment to the *status quo*. A historical overview may tell us how we got to where we are, but it does not tell us which approach is preferable. We still have to examine whether there are policy reasons which support a change in the current system.²¹¹ The next chapter will therefore discuss how the principles relating to the operation of set-off are applied in South African law. It will especially consider whether any policy reasons exist which would justify a reform with regards to these principles.

²⁰⁹ Van der Merwe et al *Contract* 470.

²¹⁰ 2000 *TR* 559.

²¹¹ Pichonnaz 2000 *TR* 559; Van der Merwe et al *Contract* 470.

CHAPTER 3: THE REQUIREMENTS FOR AND OPERATION OF SET-OFF

3 1 Introduction

The previous chapter discussed the historical development of set-off and explained how the dispute with regards to the manner in which set-off operates originated and evolved. It became apparent that “[h]istorical sources contain no decisive answer to the question of how set-off operates ... [and that] the issue must be decided by a judicial evaluation of the appropriate policy and principles.”¹ In this chapter the nature of set-off in modern South African law will be analysed: does it operate automatically or must a party raise it before it is applicable? The practical effect of these approaches and the policy considerations informing them will also be examined. Furthermore, this chapter will investigate the approaches adopted in civilian jurisdictions in an attempt to determine whether these approaches suggest possible solutions to the current problems surrounding the operation of set-off in South African law.

Before this analysis is undertaken, it is essential first to obtain a firm grasp of the general requirements for set-off which are applicable in South African law. These requirements not only determine whether set-off can take place, but may also play a role when the different approaches to set-off are evaluated.

A preliminary remark regarding terminology is also required. For set-off to operate, each party must be both a debtor and a creditor of the other party, which makes it difficult to distinguish between the parties when referring to them. To avoid confusion, this chapter will refer to the “creditor” or “plaintiff” as the person attempting to collect on the debt owed to him, and “debtor” or “defendant” as the person with a counterclaim who invokes or can invoke set-off, unless otherwise indicated. Although the creditor/plaintiff can also rely on set-off, it will usually be the debtor/defendant who raises set-off as a defence against the other party’s claim.

¹ S van der Merwe, LF van Huyssteen, MFB Reinecke & GF Lubbe *Contract – General Principles* 4 ed (2012) 470 n 230.

3 2 Requirements for set-off in South African law

The requirements for set-off in South African law have remained relatively unchanged from those accepted in Roman-Dutch law,² and are mostly settled and uncontentious. It is firstly required that the debts must exist between the same parties in the same capacities.³ Therefore, if the creditor brings a claim in a representative capacity, for instance as a trustee, the debtor cannot invoke set-off in respect of a claim the creditor owes him in his personal capacity.⁴ A debtor is also not entitled to set off a debt owed to his creditor against a debt his creditor owes to a third party,⁵ even where the third party consents to such set-off.⁶

This apparently simple principle becomes somewhat more complex where multiple debtors or creditors are involved. A debt which originates from a relationship of common or collective joint liability, i.e. where multiple debtors jointly owe the same debt, cannot be set off against an obligation which the creditor has towards only some of the debtors.⁷ If the debtors are jointly and severally liable, the view is mostly held that set-off can only operate if the creditor sues the party who also has a claim against him.⁸ The other debtors cannot invoke set-off, because there is no mutuality of debt

² See ch 2 (2 4 2).

³ LTC Harms "Obligations" in WA Joubert (ed) *The Law of South Africa* 19 2 ed (2006) para 244; DJ Joubert *General Principles of the Law of Contract* (1987) 290; RH Christie & GB Bradfield *Christie's The Law of Contract in South Africa* 6 ed (2011) 498; D Hutchison & F Du Bois "Contracts in General" in F Du Bois (ed) *Wille's Principles of South African Law* 9 ed (2007) 733 824; CG Hall *Maasdorp's Institutes of South African Law 3: The Law of Contracts* 9 ed (1978) 416; *Capricorn Beach Home Owners Association v Potgieter t/a Nilands* 2014 1 SA 46 (SCA) 49; *Road Accident Fund v Myhill* NO 2013 5 SA 426 (SCA).

⁴ Van der Merwe et al *Contract* 470; Harms "Obligations" in *LAWSA* 19 para 244; JC de Wet & AH van Wyk *Die Suid-Afrikaanse Kontrakereg en Handelsreg* 1 5 ed (1992) 274-275; Joubert *Law of Contract* 290; Christie & Bradfield *Law of Contract* 498; *Exley v Exley* 1952 1 SA 644 (O); *Strachan v The Master* 1963 2 SA 620 (N); *The Government v Regna-Adwel Business Machines Africa (Pty) Ltd* 1970 2 SA 428 (T).

⁵ Van der Merwe et al *Contract* 470; *Standard Bank of SA Ltd v SA Fire Equipment (Pty) Ltd* 1984 2 SA 693 (C).

⁶ See Harms "Obligations" in *LAWSA* 19 para 244 and the authorities cited there; Hall *Maasdorp's Institutes* 3 416.

⁷ Van der Merwe et al *Contract* 470; Harms "Obligations" in *LAWSA* 19 para 244; *Strydom v Protea Eiendomsagente* 1979 2 SA 206 (T).

⁸ Van der Merwe et al *Contract* 470; Harms "Obligations" in *LAWSA* 19 para 244; De Wet & Van Wyk *Kontrakereg* 1 275; *Bain v Barclays Bank (DC & O) Ltd* 1937 SR 191. Also see *J R & M Moffett (Pty) Ltd v Kolbe Eiendoms Beleggings (Edms) (Bpk)* 1974 2 SA 426 (O) 432; *Standard Bank of SA Ltd v SA Fire Equipment (Pty) Ltd* 1984 2 SA 693 (C) 697-698; and the discussion at 3 4 2 1 n 115 below.

between them and the creditor.⁹ Thus, where A, B and C are jointly and severally indebted to D, who is in turn indebted to A, only A will be entitled to raise set-off against D's claim. B and C will not be able to rely on set-off. However, once set-off has operated between the creditor (D) and the debtor (A), the other debtors are released to the extent that the debt for which they are jointly and severally liable has been extinguished.¹⁰ The same is true of a relationship involving multiple creditors.¹¹ Thus, where A is indebted to B, C and D, and A also has a claim against B, set-off can only operate where A is sued by B. A will not be able to rely on set-off where either C or D claims from him.

However, a surety may rely on set-off between the principal debtor and the creditor.¹² According to Van der Merwe and others,¹³ this flows from the accessory nature of the liability of the surety and is therefore not in conflict with the requirement of mutuality of debts. In other words, the surety is not trying to reduce its own indebtedness, but is demanding that set-off takes place between the creditor and principal debtor before the creditor brings proceedings against him.¹⁴

Another ostensible exception to the mutuality requirement is where a debt is ceded. In such a case the cedent is no longer the creditor, because he is succeeded by the cessionary,¹⁵ and there is thus no longer a mutuality of debts between him and the debtor. Despite this, the debtor can still rely on set-off against the cedent if set-off was

⁹ Van der Merwe et al *Contract* 470; Harms "Obligations" in *LAWSA* 19 para 244; Hall *Maasdorp's Institutes* 3 416; *Bain v Barclays Bank (DC & O) Ltd* 1937 SR 191.

¹⁰ Christie & Bradfield *Law of Contract* 264-265; *Standard Bank of SA Ltd v SA Fire Equipment (Pty) Ltd* 1984 2 SA 693 (C) 698.

¹¹ Van der Merwe et al *Contract* 470; Harms "Obligations" in *LAWSA* 19 para 244; De Wet & Van Wyk *Kontraktereg* 1 275; Hall *Maasdorp's Institutes* 3 416.

¹² Van der Merwe et al *Contract* 470-471; Joubert *Law of Contract* 290; Christie & Bradfield *Law of Contract* 499; Hall *Maasdorp's Institutes* 3 417-418; JJ Henning & KL Mould "Suretyship" in WA Joubert & JA Faris (eds) *The Law of South Africa* 26 2 ed (2015) para 291; *J R & M Moffett (Pty) Ltd v Kolbe Eiendoms Beleggings (Edms) (Bpk)* 1974 2 SA 426 (O) 432; *Standard Bank of SA Ltd v SA Fire Equipment (Pty) Ltd* 1984 2 SA 693 (C) 698; *Miller v Muller* 1965 4 SA 458 (C). However, see *Dominick v Nedbank Limited* (20463/14) 2015 ZASCA 160 (13 November 2015) and the discussion of that case in ch 4 (4 2 2 1).

¹³ *Contract* 471.

¹⁴ Harms "Obligations" in *LAWSA* 19 para 244 n 2.

¹⁵ GF Lubbe & PM Nienaber "Cession" in WA Joubert (ed) *The Law of South Africa* 3 3 ed (2013) para 178.

possible before the cession.¹⁶ However, this is not a real exception:¹⁷ the mutuality requirement did at one time exist, which means that set-off would have operated automatically before the cession took place (whereafter there was no claim that could be ceded)¹⁸ or its operation would be retrospective to the time the requirements for set-off were met.¹⁹

The second requirement for set-off to operate is that the debts must be capable of set-off.²⁰ This requires that the debts must be of the same kind.²¹ Monetary debts are *eiusdem generis* and capable of set-off,²² but it is uncertain whether this will be the case where different currencies are involved.²³ However, nothing prevents set-off from operating where non-monetary obligations are owed,²⁴ as long as the obligations pertain to the same class and quality, for example the same type and grade of grain.²⁵ Where a specific item is identified within a class, set-off will not be able to apply, for instance where a horse is mentioned by name.²⁶

Set-off will also not be allowed where the debts are illegal.²⁷ Set-off cannot operate if there is a common-law or statutory prohibition against set-off²⁸ or if it is contrary to public policy.²⁹ Therefore, set-off in respect of taxes or claims for maintenance

¹⁶ Lubbe & Nienaber "Cession" in *LAWSA* 3 para 178; De Wet & Van Wyk *Kontraktereg* 1 283-284; Christie & Bradfield *Law of Contract* 499; Van der Merwe et al *Contract* 471, 475; Hutchison & Du Bois "Contracts in General" in *Wille's Principles* 834; *Van Aswegen v Pienaar* 1967 3 SA 677 (O); *Transkei Development Corporation Ltd v Oshkosh Africa (Pty) Ltd* 1986 1 SA 150 (C) 155D; *Maharaj v Sanlam Life Insurance Ltd* 2011 6 SA 17 (KZD) para 10.

¹⁷ *Standard Bank of SA Ltd v SA Fire Equipment (Pty) Ltd* 1984 2 SA 693 (C) 697-698; Hutchison & Du Bois "Contracts in General" in *Wille's Principles* 834.

¹⁸ *Standard Bank of SA Ltd v SA Fire Equipment (Pty) Ltd* 1984 2 SA 693 (C) 698.

¹⁹ See 3 4 2 2 below.

²⁰ Joubert *Law of Contract* 290.

²¹ Harms "Obligations" in *LAWSA* 19 para 244, with reference to Van Leeuwen *Censura Forensis* 1 4 36 15, Voet *Commentarius* 16 27 and various others; Van der Merwe et al *Contract* 471; De Wet & Van Wyk *Kontraktereg* 1 277; Hutchison & Du Bois "Contracts in General" in *Wille's Principles* 833.

²² Van der Merwe et al *Contract* 471; Joubert *Law of Contract* 290.

²³ Although not often considered in South Africa, it has been very relevant in Europe (it is termed "the most important practical question in this context in O Lando, H Beale, A Prüm & R Zimmermann (eds) *The Principles of European Contract Law: Part III* (2003) 140. Also see R Zimmermann *Comparative Foundations of the European Law of Set-Off and Prescription* (2002) 48; P Pichonnaz & L Gullifer *Set-Off in Arbitration and Commercial Transactions* (2014) 37).

²⁴ Hall *Maasdorp's Institutes* 3 414.

²⁵ Van der Merwe et al *Contract* 471; De Wet & Van Wyk *Kontraktereg* 1 277; Joubert *Law of Contract* 290.

²⁶ Van der Merwe et al *Contract* 471; De Wet & Van Wyk *Kontraktereg* 1 277.

²⁷ Christie & Bradfield *Law of Contract* 497.

²⁸ Joubert *Law of Contract* 290.

²⁹ Van der Merwe et al *Contract* 471.

currently due is not allowed, although claims in respect of arrear maintenance are susceptible to set-off.³⁰

A third requirement is that both debts must be due and payable,³¹ and therefore enforceable. By relying on set-off, the debtor settles or reduces his debt and simultaneously compels the creditor to discharge or reduce his debt. It thus constitutes a manner of enforcement of the debtor's claim.³² Because the creditor cannot be required to perform before the debt is due, the debtor cannot invoke set-off before the debt owed to him is due and enforceable.³³ If a debt is subject to either a suspensive condition or time-clause, it cannot be set off,³⁴ unless the party in whose favour the clause operates waives the benefit of that clause.³⁵ Where the claim is unenforceable (even only temporarily), set-off cannot operate in respect of that claim.³⁶ The exception is natural obligations, where set-off is allowed even though such obligations are not enforceable.³⁷ This exception probably does not pertain to a prescribed debt, where

³⁰ Van der Merwe et al *Contract* 471; Harms "Obligations" in *LAWSA* 19 para 243; De Wet & Van Wyk *Kontraktereg* 1 281; *Schierhout v Union Government (Minister of Justice)* 1926 AD 286; *Tregoning v Tregoning* 1914 WLD 95; *Luttig v Luttig* 1994 1 SA 524 (O); *Commissioner of Taxes v First Merchant Bank of Zimbabwe Ltd* 1998 1 SA 27 (ZS).

³¹ Harms "Obligations" in *LAWSA* 19 para 244; Joubert *Law of Contract* 290; Christie & Bradfield *Law of Contract* 496; Van der Merwe et al *Contract* 472; Hutchison & Du Bois "Contracts in General" in *Wille's Principles* 833; Hall *Maasdorp's Institutes* 3 419; *Van Preen v Preen's Properties (Pty) Ltd* 1948 1 SA 335 (T); *Treasurer-General v Van Vuren* 1905 TS 582 589-590; *Roman Catholic Church (Klerksdorp Diocese) v Southern Life Association Ltd* 1992 2 SA 807 (A) 814-815; *Siltek Holdings (Pty) Ltd (in liquidation) t/a Workgroup v Business Connexion* 2009 1 All SA 571 (SCA).

³² P Pichonnaz "Set-Off *Compensatio*: From Diversity to Unity – Comments on the Principles of European Contract Law Part Three" in A Vaquer (ed) *The Principles of European Contract Law Part III* (2005) 281 289.

³³ Christie & Bradfield *Law of Contract* 496.

³⁴ Van der Merwe et al *Contract* 472; Harms "Obligations" in *LAWSA* 19 para 244; De Wet & Van Wyk *Kontraktereg* 1 278; *Siltek Holdings (Pty) Ltd (in liquidation) t/a Workgroup v Business Connexion* 2009 1 All SA 571 (SCA); *Schnehage v Bezuidenhout* 1977 1 SA 362 (O) 365; *Asco Carbon Dioxide Ltd v Lahner* 2005 3 SA 213 (N).

³⁵ De Wet & Van Wyk *Kontraktereg* 1 278; Van der Merwe et al *Contract* 472; Harms "Obligations" in *LAWSA* 19 para 244.

³⁶ Van der Merwe et al *Contract* 472; Harms "Obligations" in *LAWSA* 19 para 244; *Schnehage v Bezuidenhout* 1977 1 SA 362 (O) 366.

³⁷ Harms "Obligations" in *LAWSA* 19 para 244; De Wet & Van Wyk *Kontraktereg* 1 277-278; Joubert *Law of Contract* 291; *Nichol v Burger* 1990 1 SA 231 (C); *Fensham v Jacobson* 1951 2 SA 136 (T); *Allison v Massel & Massel* 1954 4 SA 569 (T); *Rosen v Wasserman* 1984 1 SA 808 (W). For criticism of the judgment in *Nichol v Burger* 1990 1 SA 231 (C), see JR Midgley "Wagers, Natural Obligations and Set-Off" (1990) 107 *SALJ* 381. For an opposing view regarding gambling transactions, see *Gibson v Van der Walt* 1952 1 SA 262 (A).

in terms of the common law set-off was not allowed if the necessary mutuality of debts did not exist before prescription set in.³⁸

According to De Wet and Van Wyk, only the claim sought to be raised in set-off by the debtor needs to be due and enforceable.³⁹ They contend that the creditor's claim does not need to be due and enforceable, but merely payable (i.e. capable of being fulfilled).⁴⁰ Their argument is that it is sufficient that the debtor is entitled to perform: if he is entitled to satisfy the creditor's claim by payment (even if the debt is not yet due and enforceable), there is no reason to prevent him from doing so by way of set-off.⁴¹ By declaring set-off, the debtor enforces his claim (which must be due and enforceable) and also discharges the creditor's claim.

This argument is logical if the view is held that set-off operates when it is declared by one of the parties, since it is possible to distinguish between the debtor's and creditor's claim. However, it is clearly irreconcilable with the view that set-off operates automatically.⁴² In terms of that view, neither party has to declare set-off and therefore neither specifically enforces his claim. It is therefore impossible to distinguish between the two claims, which means one cannot determine which claim must be due and enforceable and which one merely needs to be payable. The reason for holding that the claim of the creditor only needs to be payable, namely that the debtor is electing to discharge his debt earlier, also disappears if the debtor does not have the benefit of deciding whether to declare set-off. Furthermore, if De Wet and Van Wyk's view is accepted but set-off is held to operate *ipso iure*, determining when set-off operated will be problematic: if the one claim is due and enforceable, will set-off operate automatically the moment the other claim becomes payable or should both claims be

³⁸ De Wet & Van Wyk *Kontraktereg* 1 277; Christie & Bradfield *Law of Contract* 497. Christie and Bradfield further argue that this position has not been changed by the Prescription Act 68 of 1969 (*Law of Contract* 497).

³⁹ *Kontraktereg* 1 278. Joubert seems to share their opinion (*Law of Contract* 290).

⁴⁰ De Wet & Van Wyk *Kontraktereg* 1 278. It also corresponds with the view generally prevailing in European legal systems, namely that only the debt sued upon by the person declaring set-off needs to be due, since set-off amounts to a form of enforcement of his claim. However, French law (which attributes an *ipso iure* effect to set-off) require that both debts must be due and enforceable, since the automatic operation of set-off means that there is not one party declaring set-off (Zimmermann *European Law of Set-Off* 50-51).

⁴¹ De Wet & Van Wyk *Kontraktereg* 1 278.

⁴² BvD van Niekerk "Some Thoughts on the Problem of Set-Off" (1968) 85 SALJ 31 34; E Kahn *Contract and Mercantile Law through the Cases* (1971) 280.

due and enforceable? Depending on which approach to the operation of set-off is adopted, De Wet and Van Wyk's opinion could either be, as they describe it, entirely consistent with "die voorskrifte van gesonde verstand en die algemene beginsels in verband met voldoening"⁴³ or it could be nearly impossible to apply.

Lastly, the debts must be liquidated,⁴⁴ which means they must be capable of speedy and easy proof.⁴⁵ The reason for this requirement is that where the plaintiff can easily prove (or has already proven) his claim, judgment should not be unnecessarily delayed due to complex counterclaims.⁴⁶ Conversely, the plaintiff should not be able to defeat a defence of set-off merely by denying or querying a debt in respect of which set-off would otherwise be allowed.⁴⁷ A debtor who has an illiquid counterclaim cannot immediately rely on set-off, but if he institutes a claim in reconvention and the judge gives judgement thereon, his claim will become liquidated and therefore capable of set-off.⁴⁸

Although most authors are of the view that both debts have to be liquidated in order for set-off to operate,⁴⁹ De Wet and Van Wyk argue that only the debtor's counterclaim needs to be liquid.⁵⁰ They aver that there is no logical reason why an illiquid main claim should be immune from set-off.⁵¹ Again, this follows from their support of the

⁴³ *Kontraktereg* 1 279: "what is dictated by common sense and the general principles with regards to performance" (own translation).

⁴⁴ Harms "Obligations" in *LAWSA* 19 para 244 with reference to Grotius 3 40 8, Van Leeuwen *Cens For* 1 4 36 3 and others; Joubert *Law of Contract* 291; Van der Merwe et al *Contract* 472; Christie & Bradfield *Law of Contract* 495; Hutchison & Du Bois "Contracts in General" in *Wille's Principles* 833; *Lester Investments (Pty) Ltd v Narshi* 1951 2 SA 464 (C) (see specifically 469E-F: "The debt must be liquid either in the sense that it is based on a liquid document or is admitted or its money value has been ascertained or in the sense that it is capable of prompt ascertainment"); *Hardy NO v Harsant* 1913 TDP 433; *Blakes Maphanga Inc v Outsurance Insurance Co* 2010 4 SA 232 (SCA); *Treasurer-General v Van Vuren* 1905 TS 582; *Adjust Investments (Pty) Ltd v Wiid* 1968 3 SA 29 (O); *Tierfontein Boerdery (Edms) Bpk v Weber* 1974 3 SA 445 (C); *Janowskv v Payne* 1989 2 SA 562 (C); *AAA Brick Co (Pty) Ltd v Coetzee* 1996 3 SA 578 (BSC); *Academy of Learning (Pty) Ltd v Hancock* 2001 1 SA 941 (C); *Muller v Botswana Development Corporation Ltd* 2003 1 SA 651 (SCA).

⁴⁵ Van der Merwe et al *Contract* 472; Harms "Obligations" in *LAWSA* 19 para 244; *Treasurer-General v Van Vuren* 1905 TS 582 589.

⁴⁶ De Wet & Van Wyk *Kontraktereg* 1 279; *Trotman v Edwick* 1950 1 SA 376 (C).

⁴⁷ Christie & Bradfield *Law of Contract* 495; Hall *Maasdorp's Institutes* 3 418.

⁴⁸ Van der Merwe et al *Contract* 472; *Standard Bank of SA Ltd v SA Fire Equipment (Pty) Ltd* 1984 2 SA 693 (C); *Consol Ltd t/a Consol Glass v Twee Jongegezellen* 2002 2 SA 580 (C). Also see Rule 22(4) of the Uniform Rules of Court.

⁴⁹ Van der Merwe et al *Contract* 472; Harms "Obligations" in *LAWSA* 19 para 244; Hutchison & Du Bois "Contracts in General" in *Wille's Principles* 833.

⁵⁰ *Kontraktereg* 1 280-282.

⁵¹ 280-281.

retrospective view: according to them the debtor should be able to invoke his (liquid) claim against whatever he may owe the creditor.⁵² For instance, where A owes B an unliquidated amount for damages, but A also has a claim against B for R1000, they argue that nothing prevents A from stating that any amount he may owe B must be reduced by up to R1000. This will speak against the *ipso iure* operation of set-off for two reasons: (a) as discussed above, in terms of the *ipso iure* view no distinction can be drawn between the two claims because neither party has to declare set-off; and (b) if the amount of one or both the respective debts are uncertain, it cannot be calculated to what extent they automatically discharge each other. Thus, the automatic approach will require that both debts are liquidated.⁵³ De Wet and Van Wyk are further of the opinion that where the creditor's claim is not easily proven, a claim by the debtor which is not easily ascertainable can be taken into account.⁵⁴ For the same reasons as mentioned above, this reasoning is only consistent with the view that a declaration is required for set-off to operate.

Joubert adds a last requirement, namely that set-off must not be contractually excluded.⁵⁵ Rather than constitute a requirement, this can be classified as a manner in which set-off can be excluded and will therefore be discussed in the next chapter.

Despite the fact that the requirements for set-off are relatively settled, it becomes apparent that the approach that is adopted in respect of the operation of set-off will have an impact on the manner in which these requirements are applied. This can be seen with regard to more than one of the requirements, for instance the mutuality requirement in the case of multiple debtors (which will be discussed in more detail later),⁵⁶ the requirement that the debts must be due and enforceable and the liquidity requirement. This inevitable link between the requirements for and operation of set-off also informs the evaluation of the different approaches undertaken below.⁵⁷

⁵² 281.

⁵³ Kahn *Contract and Mercantile Law* 280.

⁵⁴ 279.

⁵⁵ Joubert *Law of Contract* 292.

⁵⁶ See 3 4 2 1 below.

⁵⁷ See specifically 3 6 below.

3 3 **Theoretical framework: possible approaches to the operation of set-off**

As seen in the previous chapter, different approaches to the operation of set-off have evolved in response to what Zimmermann calls “the heritage of Justinian’s dark pronouncements”.⁵⁸ Before embarking on a discussion of the approaches recognised in South African law and their practical effect, it may be beneficial first to provide a framework of the different models of set-off which can be distinguished and the characteristics of each of these models.

Zimmermann⁵⁹ provides a useful five-fold distinction of the different models of set-off which have developed. At the one end of the spectrum is the view that set-off leads to an automatic discharge of the debts, *ipso iure*, as soon as they are in mutual existence. In terms of this view, which was developed by the Glossators and subsequently adopted by the French historical school,⁶⁰ no action or declaration is required by either of the parties in order for set-off to operate. At the moment the requirements for set-off are fulfilled, the creditor’s claim is extinguished to the extent that set-off can operate, interest will cease to run and any surety and security will be released.⁶¹ There can be no breach of contract if the debtor fails to perform after set-off could operate, and any performance will be an *indebitum* and could therefore be reclaimed by the debtor as an undue amount.⁶² This view reinforces the payment function of set-off as a convenient mechanism to avoid duplication of performance and to promote the speedy settlement of debts,⁶³ since the debts are extinguished at the earliest possible moment without requiring any action by the parties.⁶⁴

⁵⁸ *European Law of Set-Off* 41.

⁵⁹ 32-34.

⁶⁰ See ch 2 (2 4 1).

⁶¹ Joubert *Law of Contract* 289.

⁶² 289.

⁶³ See ch 1 (1 2 nn 39 and 40).

⁶⁴ C Jauffret-Spinosi “UNIDROIT 2000 Study L – Doc 62 bis: Position Paper” (2000) UNIDROIT 1 <<http://www.unidroit.org/english/documents/2000/study50/s-50-062bis-e.pdf>> (accessed 30-11-2015). For South African law see Van der Merwe et al *Contract* 469; for French law see CH de Pardieu & O Hubert “France” in W Johnston & T Werlen *Set-Off Law and Practice: An International Handbook* (2006) 161 168; for Belgian law see M Vermylen “Belgium” in W Johnston & T Werlen *Set-Off Law and Practice: An International Handbook* (2006) 49 49-50.

Article 1290 of the French Civil Code (*Code Civil*) sets out the rule above.⁶⁵ In practice however, French courts require set-off to be pleaded in court and they therefore apply a second model: set-off operates *ipso iure*, but subject to it being pleaded in judicial proceedings.⁶⁶ This corresponds with the view advanced by the majority of the Glossators.⁶⁷ It is generally held that set-off must merely be pleaded to inform the court that the debts have been extinguished automatically.⁶⁸ This construction shares all the characteristics of the *ipso iure* approach and the consequences will be similar, although it is subject to the condition that set-off must be raised in court. But there is no notion that pleading set-off triggers its retrospective operation; set-off occurred, its operation was merely suspended until it was pleaded.

A third model, followed in Scotland, is that set-off must be pleaded in court and only takes effect once it is sustained by judgment.⁶⁹ Unlike the previous two models, set-off does not operate automatically in terms of this approach. However, once it is sustained by judgment, it works retrospectively. This retrospective operation means that there ultimately is not really a practical difference between this approach and the *ipso iure* approaches highlighted above.⁷⁰

A fourth approach, which was followed by the German Pandectists⁷¹ and adopted in German law, requires that set-off be asserted by an “extrajudicial, informal and unilateral declaration to the other party, whereupon it works retrospectively.”⁷² Generally, a retrospective effect is only attributed to the effect of set-off.⁷³ Therefore, all the requirements for set-off must be met at the time a party seeks to rely on it, and set-off will not be allowed if one of the requirements has ceased to exist at the time of the declaration.⁷⁴ However, in certain jurisdictions (including, possibly, South African

⁶⁵ See 3 5 1 below.

⁶⁶ Zimmermann *European Law of Set-Off* 32.

⁶⁷ See ch 2 (2 4 1).

⁶⁸ De Groot *Inl 3 40 7 tr Maasdrorp Introduction* 334; J Voet *Commentarius ad Pandectas* 16 2 2 tr P Gane *The Selective Voet being the Commentary on the Pandects by Johannes Voet and the Supplement to that Work by Johannes van der Linden* 3 (1956) 149-150; Van der Keessel *Praelectiones ad Gr 3 40 7 tr Van Warmelo et al Voorlesinge* 429.

⁶⁹ Zimmermann *European Law of Set-Off* 32; Pichonnaz & Gullifer *Set-Off in Arbitration* 29, 147.

⁷⁰ Zimmermann *European Law of Set-Off* 33; Pichonnaz & Gullifer *Set-Off in Arbitration* 29.

⁷¹ See ch 2 (2 4 3).

⁷² Zimmermann *European Law of Set-Off* 33.

⁷³ 36.

⁷⁴ 36.

law)⁷⁵ a retrospective effect is attributed to the declaration itself. If that is the case, set-off will be allowed if its requirements were met sometime in the past, even if it is no longer the case at the time set-off is declared.

Because set-off does not operate automatically, the retrospective approach allows the debtor to elect instead to pay the creditor's claim and thereby preserve his own claim.⁷⁶ However, the retroactive effect attributed to set-off would render its practical effect largely similar to that of the *ipso iure* approach: no interest would accrue after the debt became susceptible to set-off⁷⁷ (or at least, any obligation to pay such interest would be nullified)⁷⁸ and a breach of contract would be cured retrospectively.⁷⁹ This notion of set-off supports its so-called security function,⁸⁰ since a party can have his claim fulfilled or partially fulfilled whenever he elects to do so by declaring set-off.⁸¹ A creditor who is able to benefit from set-off is therefore in a more secure position than other creditors.

A fifth possible approach to set-off, adopted in the PICC and the PECL, attributes an *ex nunc* effect to a declaration of set-off.⁸² This means that set-off has no effect until a unilateral declaration (which can be made informally and extrajudicially) is made by either one of the parties. At the moment of the declaration, interest ceases to run, the debts are extinguished and any sureties or securities are released.⁸³

With these possible approaches in mind, the position in South African law can now be considered. It must be determined which approaches are adopted here, whether one of these optimally supports the practical utility of set-off and, if not, which of the other models identified above offers a better solution.

⁷⁵ See 3 4 below.

⁷⁶ Joubert *Law of Contract* 289.

⁷⁷ Zimmermann *European Law of Set-Off* 37.

⁷⁸ Joubert *Law of Contract* 289.

⁷⁹ 289.

⁸⁰ See ch 1 (1 2 n 41).

⁸¹ Jauffret-Spinosi "UNIDROIT 2000 Study L – Doc 62 bis: Position Paper" *UNIDROIT* 1; K Böhlhoff & J Budde "The Law of Set-Off in Germany" 1984 *Int'l Fin L Rev* 28 28.

⁸² Zimmermann *European Law of Set-Off* 41.

⁸³ Pichonnaz "Compensatio" in *Principles of European Contract Law* 297; Pichonnaz & Gullifer *Set-Off in Arbitration* 184-185.

3 4 Operation of set-off in South Africa

The uncertainty inherited from the Roman-Dutch law resulted in several questions surrounding the operation of set-off in South African law. Most of these stem from the fact that South African law has failed to settle on one approach to set-off. Instead, there is authority for two approaches to set-off: it is either said to operate *ipso iure*, i.e. automatically, but still has to be pleaded and proven as a defence or that it requires a declaration to operate, but then does so retrospectively. These two approaches largely correspond with the second and the fourth theoretical approaches highlighted above, although both are subject to a range of exceptions.

3 4 1 The debate on whether set-off operates *ipso iure* or retrospectively

It is generally understood that the question of whether set-off operates *ipso iure* or retrospectively, was answered in favour of the *ipso iure* approach by the Appellate Division in *Schierhout v Union Government (Minister of Justice)*.⁸⁴ It was held that:

“When two parties are mutually indebted to each other, both debts being liquidated and fully due, then the doctrine of compensation comes into operation. The one debt extinguishes the other *pro tanto* as effectually as if payment had been made. Should one of the creditors seek thereafter to enforce his claim, the defendant would have to set up the defence of *compensatio* by bringing the facts to the notice of the Court - as indeed the defence of payment would also have to be pleaded and proved. But, compensation once established, the claim would be regarded as extinguished from the moment the mutual debts were in existence together.”⁸⁵

The courts have since on numerous occasions confirmed that set-off operates automatically by operation of law⁸⁶ and this view seems to be accepted in the majority of case law.⁸⁷ In terms of this view, the debts are extinguished as soon as they are in

⁸⁴ 1926 AD 286.

⁸⁵ 289-290.

⁸⁶ *Schierhout v Union Government (Minister of Justice)* 1926 AD 286; *Blakes Maphanga Inc v Outsurance Insurance Co* 2010 4 SA 232 (SCA); *Standard Bank of South Africa Ltd v Echo Petroleum CC* 2012 5 SA 283 (SCA); *Western Cape Housing Development Board v* 2005 1 SA 462 (C); *Choice Holdings Ltd v Yabeng Investment Holding Co Ltd* 2001 3 SA 1350 (W); *Southern Cape Liquors (Pty) Ltd v Delipcus Beleggings BK* 1998 4 SA 494 (C); *Nichol v Burger* 1990 1 SA 231 (C); *Great North Farms (Edms) Bpk v Ras* 1972 4 SA 7 (T); *Van Aswegen v Pienaar* 1967 3 SA 677 (O); *SA Metropolitan Life Assurance Co Ltd v Ferreira* 1962 4 SA 213 (O); *Lester Investments (Pty) Ltd v Narshi* 1951 2 SA 464 (C).

⁸⁷ Van der Merwe et al *Contract* 473. Also see the cases listed in n 86 above.

mutual existence, although the defendant is required to plead and prove set-off as a defence.⁸⁸ This approach is in line with the approach favoured by the majority of Roman-Dutch jurists.⁸⁹

Requiring a party to plead and prove set-off as a defence ostensibly contradicts the view that set-off operates automatically. However, as in Roman-Dutch law,⁹⁰ the reason for this requirement is merely to inform the court that set-off took place.⁹¹ This, it is argued, is purely a procedural requirement⁹² and places an evidentiary burden on the defendant to prove that set-off operated. This is similar to a scenario where the defendant paid the debt before action was instituted, and subsequently has to prove that payment was made.

The problem with ascribing automatic operation to set-off, but still requiring it to be pleaded and proved, was identified even earlier than the *Schierhout* case in our law by Mason J in *Hardy NO v Harsant*,⁹³ where he asks:

“[W]hat is meant by the saying that compensation operates *ipso jure* or automatically as the cases sometimes put it[?] ... Pothier (sec. 638) lays down very definitely that compensation operates as of right and extinguishes the respective debts of the parties even if neither party has alleged it and even if the Court has not adjudicated upon it. And Voet (16, 2, 2) uses somewhat similar though perhaps less emphatic language. But these two authors nevertheless use everywhere such phrases as pleading or opposing or offering a debt in compensation and similar words are used in the civil law to indicate that it is a right which parties must claim if they desire to have the benefit of it. (See Huber, Praelect, Juris Civilis, lib. 4, tit. 6, p. 450 n. 30.) I am not aware of any passage or any case which requires a Court to apply the doctrine of set-off when neither party desires to raise it; as Pothier puts it in section 639 on this subject, it is a fiction of law introduced for the benefit of the parties between whom compensation applies and, therefore, differs widely from those cases in which the Court must decide a question arising in legal proceedings whatever be the wishes of the litigants, such as whether an Act is absolutely prohibited by law or whether as in

⁸⁸ *Herrigel NO v Bon Roads Construction Co (Pty) Ltd* 1980 4 SA 669 (SWA) 676F; *Altech Data (Pty) Ltd v M B Technologies (Pty) Ltd* 1998 3 SA 748 (W); *Southern Cape Liquors (Pty) Ltd v Delipcus Beleggings BK* 1998 4 SA 494 (C); *Bester v Boyd & Thorne Investments CC t/a Landlords* (6947/2012) 2013 ZAWCHC 40 (26 February 2013); *Hall Maasdorp's Institutes* 3 420.

⁸⁹ See ch 2 (2 4 2).

⁹⁰ See ch 2 (2 4 2).

⁹¹ *Hall Maasdorp's Institutes* 3 420; Van der Merwe et al *Contract* 474; De Wet & Van Wyk *Kontraktereg* 1 282; *Van Aswegen v Pienaar* 1967 3 SA 677 (O) 681.

⁹² JH Loots & P Van Warmelo “Compensatio” (1956) 19 *THRHR* 267 269.

⁹³ 1913 TDP 433.

matrimonial causes the Court has jurisdiction. Indeed in sections 639 and 640 Pothier deals with cases in which a creditor who has failed to plead his claim as a set-off still retains his original right of action. This certainly seems to be the effect of Dig., 16, 2, 7(1). Voet (16, 2, 3) says very clearly that a man who does not wish to set-off his claim may discharge the demand of his adversary and preserve his own right of action. Goudsmit, in his Pandects, goes even further than Voet and Pothier in requiring some definite act of the person who has the right to set-off as a condition precedent to compensation being applicable.

To sum up the result of the authorities is, we may say, that whilst either party may claim as of right that his adversary's demand has been extinguished by a liquid debt due to him, there is nothing to prevent him, if the adversary denies the right of set-off, from refraining to press the set-off and reserving his right of future action."⁹⁴

From the above it can be seen that there is a degree of uncertainty regarding the *ipso iure* operation of set-off. A minority view, adopted by courts in some instances, is that set-off does not operate automatically, but only when a party elects to rely on it.⁹⁵ However, in such cases it is said that set-off operates *ex tunc*.⁹⁶ This largely corresponds with the opinion of Van Leeuwen,⁹⁷ except that the declaration in modern South African law does not necessarily have to be made in the course of judicial proceedings.

It seems to be the accepted view in South African law that it is not only the effect of set-off which is held to operate retrospectively at the moment set-off first became possible, but the declaration is also deemed to have been made retrospectively. Therefore, the defendant is entitled to rely on set-off if it was possible sometime in the past, even if set-off is no longer possible at the time it is declared because one of the requirements is no longer satisfied (for example where the debt has been ceded and there is no longer a mutuality of debts).⁹⁸

⁹⁴ 447-448.

⁹⁵ *Bain v Barclays Bank (DC & O) Ltd* 1937 SR 191; *Herrigel NO v Bon Roads Construction Co (Pty) Ltd* 1980 4 SA 669 (SWA); *Altech Data (Pty) Ltd v M B Technologies (Pty) Ltd* 1998 3 SA 748 (W); *Harris v Tancred NO* 1960 1 SA 839 (C) 843; *Mohamed v Nagdee* 1952 1 SA 410 (A); *Bester v Boyd & Thorne Investments CC t/a Landlords* (6947/2012) 2013 ZAWCHC 40 (26 February 2013) para 6.

⁹⁶ De Wet & Van Wyk *Kontraktereg* 1 273, 282. Also see the case law mentioned in n 95 above.

⁹⁷ See ch 2 (2 4 2).

⁹⁸ De Wet & Van Wyk *Kontraktereg* 1 283-284; Harms 'Obligations' in *LAWSA* 19 para 245.

This is contrary to the general construction of the retrospective operation of set-off as discussed above,⁹⁹ as well as the approach in other civil law jurisdictions which also attribute a retrospective effect, such as Germany.¹⁰⁰ In terms of this approach, it is required that all the requirements for set-off must be met at the time the declaration is made, and only the effect of set-off is retrospective. Why South African law deviates from this view is not certain. Possibly, it is an attempt to reconcile the retrospective approach with the majority view that set-off operates *ipso iure*, since it brings the practical effect of this approach more in line with the automatic operation of set-off.

To illustrate why the effect of the retrospective approach as applied in South Africa shares a greater similarity with the *ipso iure* approach than the retrospective approach as applied in Germany, the example can be considered where a debt is ceded after it became susceptible to set-off, but before set-off is declared or relied upon.¹⁰¹ In such a case, the different approaches will bring about the following results: (a) in terms of the *ipso iure* approach, the debts would have been extinguished automatically before the cession occurred and the debtor's indebtedness to the cessionary would have been reduced accordingly; (b) in terms of the retrospective approach as applied in Germany, set-off will no longer be possible since there is no longer a mutuality of debts;¹⁰² and (c) in terms of the retrospective approach as applied in South Africa, once the debtor relies on set-off it will be deemed to have taken place before the cession and the debtor will be entitled to the benefit thereof. It is evident that for all practical purposes, (a) and (c) will yield the same result in these situations.

However, this retrospective effect of the declaration only seems to be accepted to a certain extent: if one of the debts has been settled through payment and therefore ceased to exist, it is no longer possible to declare set-off.¹⁰³ Whether this is also the case where a debt is extinguished due to prescription is unclear,¹⁰⁴ since the few cases dealing with set-off in the context of prescription seem to follow the automatic approach

⁹⁹ See 3 3 above; P Pichonnaz "The Retroactive Effect of Set-Off (*Compensatio*): A Journey through Roman Law to the New Dutch Civil Code" 2000 *TR* 541 551.

¹⁰⁰ Zimmermann *European Law of Set-Off* 36.

¹⁰¹ Also see 3 4 2 2 below.

¹⁰² However, arts 404 and 406 of the German Civil Code specifically provides for set-off where a debt has been ceded – see 3 5 2 nn 218 and 219 below.

¹⁰³ See 3 4 2 4 below, specifically n 154. Also see *Southern Cape Liquors (Pty) Ltd v Delipcus Beleggings* BK1998 4 SA 494 (C) 501A, quoted below at 3 4 2 4141.

¹⁰⁴ MM Loubser *Extinctive Prescription* (1996) 145.

to set-off and therefore accept that the debt was extinguished before it prescribed.¹⁰⁵ Nevertheless, it is arguable that the extinction of the debt due to prescription should be treated in the same manner as extinction due to payment, and therefore a declaration of set-off should no longer be possible after the debt has prescribed.¹⁰⁶

It is submitted by Harms that South African courts have not accepted all the implications of either of the *ipso iure* or retrospective approaches to set-off.¹⁰⁷ To fully understand what is meant by this statement, it is necessary to consider the practical implications of both approaches. Analysing the practical effect will also enable one to evaluate which approach, if indeed there is a practical difference between the two, is the most suitable, i.e. which approach best supports normal commercial practices.

3 4 2 The practical implications of recognising either the *ipso iure* or retrospective approach

3 4 2 1 *Multiple parties*

The first situation where a different practical result will be reached, depending on which approach is followed, concerns the rules surrounding a debt owed by or to multiple parties, for instance a debt owed by multiple co-debtors who are jointly and severally liable to a single creditor.¹⁰⁸ If it is accepted that set-off operates *ipso iure*, such a co-debtor should be entitled to rely on the fact that the creditor's claim was extinguished by way of set-off between the creditor and another co-debtor as soon as set-off became possible, and regardless of whether the creditor or the other co-debtor invoked set-off.¹⁰⁹ This is because the joint obligation is only due once¹¹⁰ – if one co-debtor performs, all the other co-debtors are absolved.¹¹¹ In terms of the *ipso iure* approach,

¹⁰⁵ *Binase v Maklutshana* (1907) 24 SC 452 454; *Swanepoel v Van der Westhuizen* 1930 TPD 806 809; *Pentecost and Co v Cape Meat Supply Co* 1933 CPD 472 476-477, 479; *Trinity Engineering (Pvt) Ltd v Anglo-African Shipping Co (Pvt) Ltd* 1986 (1) SA 700 (ZS) 702. Also see Loubser *Prescription* 147.

¹⁰⁶ This will only be the case where the debt is extinguished by prescription (such as in the case of the s 10(1) of the Prescription Act 68 of 1969), and not where it is merely rendered unenforceable due to prescription (such as in the case of s 3(1) of the old Prescription Act 19 of 1943) – see *Duet and Magnum Financial Services CC (In Liquidation) v Koster* 2010 4 SA 499 (SCA) para 21; *Standard General Insurance Co Ltd v Verdun Estates (Pty) Ltd* 1990 (2) SA 693 (A) 698-699.

¹⁰⁷ Harms "Obligations" in *LAWSA* 19 para 243.

¹⁰⁸ The situation would be similar where a co-creditor can effect set-off against a debtor.

¹⁰⁹ De Wet & Van Wyk *Kontraktereg* 1 275; AA Roberts Wessels' *The Law of Contract in South Africa* 1 2 ed (1951) 460.

¹¹⁰ Christie & Bradfield *Law of Contract* 263.

¹¹¹ Van der Merwe et al *Contract* 216.

set-off operates automatically and therefore it is not required that the parties between whom set-off can operate should rely on it before the debt is extinguished. For example: A, B and C are jointly and severally indebted to D, and A also has a claim against D. If set-off operates *ipso iure*, the debt owed to D will be reduced or extinguished automatically if the requirements for set-off are fulfilled, without A having to rely on or declare set-off.¹¹² If D now brings an action against B, B should be able to raise the defence that the debt or a part thereof has been discharged.

As is evident from the earlier discussion,¹¹³ the consequences of the *ipso iure* approach to set-off are not always accepted where multiple parties are involved. A co-debtor is often not allowed to rely on the automatic operation of set-off between another co-debtor and the creditor (although once set-off has operated as between the latter two, the co-debtor could of course maintain that the liability has been reduced accordingly). Van der Merwe and others¹¹⁴ attribute this to a lack of mutuality of claims, which is one of the requirements for set-off to operate. However, it is submitted that a mutuality of claims does exist between the creditor and one of the co-debtors (in the example, between A and D) – the fact that B is not a party thereto cannot negate that fact. This argument by Van der Merwe and others thus conflates two different things, namely the requirements of set-off, and the consequences of set-off once those requirements are met, in an attempt to explain an anomalous outcome.¹¹⁵ Allowing only the co-debtor who has a claim against the creditor to invoke set-off “clearly speaks against the *ipso iure* operation of set-off”,¹¹⁶ rather than indicating the absence of a mutuality of claims.

¹¹² De Wet & Van Wyk *Kontraktereg* 1 275.

¹¹³ See 3 2 above.

¹¹⁴ *Contract* 470.

¹¹⁵ This conflation seems to also influence the conclusion in Van der Merwe *Contract* 470 n 235. The authors point to the fact that the outcome of *J R & M Moffett (Pty) Ltd v Kolbe Eiendoms Beleggings (Edms) (Bpk)* 1974 2 SA 426 (O) and *Standard Bank of SA Ltd v SA Fire Equipment (Pty) Ltd* 1984 2 SA 693 (C) is inconsistent with the *ipso iure* operation attributed to set-off. Arguably, these cases do not support this conclusion. Although these cases confirm with the mutuality requirement, there are in fact passages in both cases which seem to support the automatic approach to set-off; in other words, once there is a mutuality of debts between a creditor and one of the co-debtors, it appears that another co-debtor can rely on the fact that set-off has occurred automatically and that at least a part of the debt has been extinguished (see *J R & M Moffett (Pty) Ltd v Kolbe Eiendoms Beleggings (Edms) (Bpk)* 1974 2 SA 426 (O) 432A-G, 433A-B; *Standard Bank of SA Ltd v SA Fire Equipment (Pty) Ltd* 1984 2 SA 693 (C) 698C). See also Roberts *Law of Contract* 1 460, who argues that co-debtors should be allowed to rely on set-off having occurred *ipso iure*, although he acknowledges that the weight of old authority does not support this view.

¹¹⁶ Harms “Obligations” in *LAWSA* 19 para 244 n 9.

This inconsistency is probably due to policy reasons: it is preferable to leave the decision whether set-off should operate to the parties whose claims are immediately affected by it. In the same manner that the law does not allow co-debtor B to compel co-debtor A to pay the creditor's demand when the creditor claims the debt from B, the law should also not permit B to rely on the automatic operation of set-off when its effect would be to compel A to abandon his claim.

Requiring the co-debtor who has a claim against the creditor to invoke set-off before it can be said to have extinguished the creditor's claim corresponds with the minority view of set-off, namely that a declaration is required by one of the parties which operates retrospectively. In this context, the view that set-off requires a declaration before it can operate produces the more desirable outcome. Whether the effect of this declaration is retrospective is not relevant in this context, as long as only the parties involved are allowed to make the declaration. It is generally recognised that set-off does not operate irrespective of the wishes of the parties and they should be allowed to preserve their autonomy by deciding whether their claims should be extinguished by set-off.¹¹⁷ Therefore, third parties should not be permitted to force two parties to effect set-off, as this would violate their autonomy.¹¹⁸

3 4 2 2 Cession

If a creditor cedes a debt after the requirements for set-off were satisfied, the debtor should, in terms of both approaches to the operation of set-off, still be able to rely on set-off against the new creditor, i.e. the cessionary.¹¹⁹ This is a natural consequence of the *ipso iure* approach, as the part of the debt which was susceptible to set-off would have ceased to exist from the moment that set-off could operate¹²⁰ and the cedent will not be able to transfer a greater right than he possesses.¹²¹ Accordingly, it was recognised in *Transkei Development Corporation Ltd v Oshkosh Africa (Pty) Ltd*¹²² that

¹¹⁷ See 3 4 1 above.

¹¹⁸ As discussed at 3 2 above, different principles apply in the case of a surety.

¹¹⁹ See the authority at n 16 above.

¹²⁰ Christie & Bradfield *Law of Contract* 499; Hall *Maasdorp's Institutes* 3 413.

¹²¹ Christie & Bradfield *Law of Contract* 499; *Standard Bank of SA Ltd v SA Fire Equipment (Pty) Ltd* 1984 2 SA 693 (C).

¹²² 1986 1 SA 150 (C).

“[i]n view of the *ipso jure* application of set off against any debts by defendant coming into existence, it follows that the claims that plaintiff acquired against defendant through cession were subject to set off to the extent to which set off had already taken place”.¹²³

In terms of the retrospective approach as applied in the South African context, a party can rely on set-off even where it was possible in the past, but one of the requirements is no longer satisfied. As discussed above, this is due to the fact that it is not only the effect of set-off which is understood to be retrospective, but the declaration would date back to the time at which set-off first became possible.¹²⁴ Thus, due to the retroactive operation of set-off, the debtor would be able to rely on set-off which was possible against the cedent, even if he declares set-off after the cession was effected.¹²⁵

Where the cedent relies on set-off, the same principles should theoretically apply. In terms of the *ipso iure* view, no declaration of set-off is required for set-off to come into effect and it should therefore not make a difference which party later raises set-off as a defence. In terms of the retrospective approach, the principle also remains the same regardless of which party invokes set-off: the effect of the declaration dates back to the moment set-off could first occur. For example, A and B are mutually indebted and all the requirements of set-off are met. A now cedes the debt owed by B to C. If the *ipso iure* approach is followed, the debt would have been extinguished by set-off before cession occurred and A or B should be able to rely on that set-off. If A declares set-off after cession of the debt according to the retrospective approach, set-off would be deemed to have taken place before the cession.

However, the courts have not been entirely consistent in this regard. In *Porterstraat 69 Eiendomme (Pty) Ltd v P A Venter Worcester (Pty) Ltd*¹²⁶ the court did not consider whether the requirements for set-off were fulfilled before the debt was ceded, but held that

“only the [cessionary] is in a position to enforce the debt against the [debtor]. [The cedent] is in no such position and can therefore not claim set-off of a claim which it may be able to prove against the outstanding amount ... which constitutes the debt owing by [the cedent]

¹²³ 155D.

¹²⁴ See 3 4 1 above.

¹²⁵ De Wet & Van Wyk *Kontraktereg* 1 283.

¹²⁶ 2000 4 SA 598 (C).

to [the debtor]. There would appear to be no compliance with the requirement that both debts must be payable to the same persons in the same capacities.”¹²⁷

On a practical level, the conclusion reached by the court is probably a sound one, as it is not desirable to allow the cedent to claim set-off after the cession was effected. However, the problem is that the court attributes this conclusion to the lack of mutuality. If the prerequisites for set-off were met before the cession was effected, the fact that one of the requirements has since ceased to exist (i.e. that there is no longer a mutual debt) should not prevent set-off from operating retrospectively in terms of the minority view. In terms of the *ipso iure* view, set-off would have already occurred, and the cedent should also not be prevented from raising it as a defence. This is again an example where the requirements for and consequences of set-off are conflated, possibly because a strict application of either approach leads to an irregular outcome (i.e. allowing a cedent to invoke set-off in respect of a debt after it has been ceded to the cessionary).

On the facts of the *Porterstraat* case, it is possible that one or both of the claims were not sufficiently liquid before the respondent effected cession, as both of the debts were disputed by the other party. Unfortunately, if that was part of the court’s reasoning, the court failed to mention it as the reason why set-off could not operate. The impression that is gained from this judgment is that a cedent is prevented from relying on set-off even where it was possible before his claim was ceded. This conclusion, although not necessarily unfair, contradicts the principles of both possible approaches to the operation of set-off.

In theory, both approaches yield the same result (at least with regards to a debtor who relies on set-off), and generally both are applied consistently with their theoretical principles. However, the operation of set-off in the case of cession is subject to certain qualifications. The first qualification is that even where the debt was not susceptible to set-off at the date of the cession, but became capable of being set off thereafter, the debtor who is unaware of the cession and in good faith attempts to set off his debt against the cedent will be allowed to rely on set-off.¹²⁸ According to Van der Merwe

¹²⁷ 612.

¹²⁸ Van der Merwe et al *Contract* 416; Lubbe & Nienaber “Cession” in *LAWSA* 3 para 178; *Agricultural & Industrial Mechanisation (Vereeniging) (Edms) Bpk v Lombard* 1974 3 SA 485 (O); *Stannic v Samib*

and others, this is not regarded as real set-off; rather, the debtor is protected as if set-off had taken place.¹²⁹ The second qualification is where the cession is made *mala fide* in order to prevent the debtor from relying on set-off and the cessionary was aware of the cedent's motive.¹³⁰ Both of these qualifications originate from the law of cession, rather than being a consequence of or deviation from the rules surrounding the operation of set-off.

3 4 2 3 *Insolvency*

The operation of set-off in the context of insolvency is similar to its operation where a debt was ceded. The creditor of an insolvent who is simultaneously indebted to the insolvent will be able to rely on set-off, as long as the requirements for set-off were met before *concurso creditorum*.¹³¹ This will be the case regardless of which approach is followed:¹³² in terms of the *ipso iure* approach the debts would have been extinguished automatically and therefore they no longer exist,¹³³ and in terms of the retrospective approach the declaration has retrospective effect, so that the debts are extinguished prior to insolvency.¹³⁴

Underwriting Managers (Pty) Ltd 2003 3 All SA 257 (SCA); *Clark v Van Rensburg* 1964 4 SA 153 (O). According to Van Niekerk 1968 SALJ 38, "[t]he basis for [this] view seems to reside in an analogy with the rule of equity that a debtor who is in the dark about the cession to a third party of the claim against him will nevertheless be released from his debt if he pays the cedent in good faith". However, in *Van Aswegen v Pienaar* 1967 3 SA 677 (O) 679 the court qualified this by stating that it is only where "n skuldenaar, handelende op sterkte van sy geregverdigde vermoede dat 'n sedent nog sy skuldeiser is, sy posisie ten opsigte van sodanige sedent tot sy nadeel verander, hy op grond van billikheidsoorwegings geregtig is om teenoor die sessionaris van die sedent sy eis teen hom as verweer op te werp dat by gebrek aan kennisgewing van die sessie aan hom, hy by magte is om hom te beroep op skuldvergelyking van sy eis teen die sedent en die gesedeerde eis." ("a creditor, acting on the strength of his justified presumption that the cedent is still his creditor, alters his position in respect of such cedent to his prejudice, that he is entitled on equitable considerations to raise against the cessionary of the cedent his claim as defence that in the absence of notice of the cession to him, he is allowed to rely on set-off of his claim against the cedent and the ceded claim" – own translation).

¹²⁹ Van der Merwe et al *Contract* 416 n 254. See also *Van Zyl NO v Look Good Clothing CC* 1996 3 SA 523 (SE).

¹³⁰ Lubbe & Nienaber "Cession" in *LAWSA* 3 para 178; Hutchison & Du Bois "Contracts in General" in *Wille's Principles* 834; *LTA Engineering Co Ltd v Seacat Investments (Pty) Ltd* 1974 1 SA 747 (A).

¹³¹ *Siltek Holdings (Pty) Ltd (in liquidation) t/a Workgroup v Business Connexion* 2009 1 All SA 571 (SCA); Christie & Bradfield *Law of Contract* 497.

¹³² Van der Merwe et al *Contract* 475.

¹³³ Christie & Bradfield *Law of Contract* 497.

¹³⁴ De Wet & Van Wyk *Kontraktereg* 1 283.

This situation is regulated by section 46 of the Insolvency Act 24 of 1936,¹³⁵ which seems to presuppose that set-off operates *ipso iure* or automatically.¹³⁶ The effect of this provision is that the creditor of an insolvent will not have to compete in a *concursum creditorum* if all the requirements for set-off were satisfied before that time,¹³⁷ although set-off may be disregarded if it was not in the ordinary course of business.

As with cession, the two approaches will produce the same practical result. There might be policy reasons for allowing a creditor of the insolvent estate to invoke set-off, since it might be seen as unfair to expect him to repay the whole of his debt towards the estate where he only receives a dividend on the debt owed to him.¹³⁸ However, permitting set-off to operate in this context causes one creditor to be favoured above the others, which contradicts a fundamental principle of the law of insolvency, namely the *pari passu* principle. It is submitted that these considerations should be evaluated and regulated within the context of insolvency law, as it is already done to a certain extent.

3 4 2 4 *Payments made after the debt is susceptible to set-off*

Arguably the biggest practical difference occasioned by the two different approaches to set-off is the status of payments made after the prerequisites for set-off have been met, but neither party has yet elected to rely on set-off. On a strict interpretation of the majority view, namely that set-off operates *ipso iure*, the original indebtedness of the debtor would have been extinguished from the moment that the requirements for set-

¹³⁵ “If two persons have entered into a transaction the result whereof is a set-off, wholly or in part, of debts which they owe one another and the estate of one of them is sequestrated within a period of six months after the taking place of the set-off, or if a person who had a claim against another person (hereinafter in this section referred to as the debtor) has ceded that claim to a third person against whom the debtor had a claim at the time of the cession, with the result that the one claim has been set-off, wholly or in part, against the other, and within a period of one year after the cession the estate of the debtor is sequestrated; then the trustee of the sequestrated estate may in either case abide by the set-off or he may, if the set-off was not effected in the ordinary course of business, with the approval of the Master disregard it and call upon the person concerned to pay to the estate the debt which he would owe it but for the set-off, and thereupon that person shall be obliged to pay that debt and may prove his claim against the estate as if no set-off had taken place: Provided that any set-off shall be effective and binding on the trustee of the insolvent estate if it takes place between an exchange or a market participant as defined in section 35A and any other party in accordance with the rules of such an exchange, or if it takes place under an agreement defined in section 35B.”

¹³⁶ Van Niekerk 1968 SALJ 37.

¹³⁷ 37.

¹³⁸ See ch 2 (2 2 2 2) for the possibility that this policy consideration was already recognised in classical Roman law.

off were met, and therefore the creditor will not be entitled to claim or receive payment of the part of the debt discharged by set-off.¹³⁹ If the debtor makes payment in respect of the extinguished claim, he would have to recover such a payment by way of the *condictio indebiti* and therefore be required to satisfy all the requirements for such a remedy.¹⁴⁰ Despite this, where neither party raises set-off, the debt can still be extinguished by payment.¹⁴¹ This creates uncertainty, as the party who made the payment does not know whether the other party will rely on set-off and therefore cannot be sure which remedy to use.

However, some authors who support the automatic operation of set-off are nevertheless of the opinion that where a debtor makes a payment to his creditor, either without realising that the requirements for set-off were met, or choosing to make the payment in order to preserve his original claim, he can thereafter rely on the original indebtedness of the creditor to enforce his counterclaim.¹⁴² This conclusion is sometimes justified by inferring a tacit agreement between the parties that set-off will not operate¹⁴³ – a construction which seems highly artificial.

This issue of reclaiming a payment made to the other party where such indebtedness was susceptible to set-off, is complicated further in the case of transactional bank accounts, where the debit and credit balances of respective accounts fluctuate continuously. It is trite that “[t]he legal relationship between a banking institution and its customer whose account with it is in credit is that of debtor and creditor”.¹⁴⁴ When

¹³⁹ De Wet & Van Wyk *Kontraktereg* 1 273; Joubert *Law of Contract* 289.

¹⁴⁰ See for instance *Southern Cape Liquors (Pty) Ltd v Delipcus Beleggings* BK1998 4 SA 494 (C) 501B, where the *obiter* statement was made that where a party settles a debt in another way, without realising that he could rely on set-off, he will be able to reclaim such payment as an undue amount by way of the *condictio indebiti*.

¹⁴¹ *Southern Cape Liquors (Pty) Ltd v Delipcus Beleggings* BK1998 4 SA 494 (C) 501A: “Indien [die skuldenaar] nie [van skuldvergelyking] gebruik wil maak nie, om welke rede ook al, staan dit hom vry om die betrokke skuld op 'n ander wyse te vereffen.” (“If the debtor decides not to rely on set-off, for whichever reason, he is free to settle the debt in another way” – own translation); S Scott “Skuldvergelyking – Toe (ex tunc) en Nou (ex nunc)” 2006 *TSAR* 595 598.

¹⁴² According to De Wet & Van Wyk, it was accepted by Voet that a party could make payment and thereby retain his counterclaim (*Kontraktereg* 1 282, with reference to Voet *Commentarius* 16 2 3). See also Hall *Maasdorp's Institutes* 3 420, who acknowledge that there may be reasons why a person would prefer not to have his debt extinguished by set-off and is therefore of the opinion that failure to plead set-off does not prevent the person from recovering the original indebtedness.

¹⁴³ Van Niekerk 1968 *SALJ* 34.

¹⁴⁴ *Ormerod v Deputy Sheriff, Durban* 1965 4 All SA 330 (D) 334, with reference to *White v Standard Bank* 1883 4 N.L.R. 88 91-92. Also see *Herrigel NO v Bon Roads Construction Co (Pty) Ltd* 1980 4 SA 669 (SWA) 674B-C; *Standard Bank of South Africa Ltd v Echo Petroleum* CC 2012 5 SA 283 (SCA) 287-288; *ABSA Bank Ltd v Intensive Air (Pty) Ltd* 2011 2 SA 275 (SCA) 279.

amounts are deposited by or on behalf of a client in his bank account, the client merely has a claim against the bank for repayment of such amounts.¹⁴⁵ If the bank extends a loan to the same client, the bank's claim arising from the loan can be set off against money in the transactional account of the client.

Therefore, in the context of a bank account, the question regarding the status of payments made after set-off could operate will arise where a bank honours an instruction of its client to pay out funds from the client's bank account, while a loan made by the bank to the client is due and payable. Consider for instance a situation where on the day the requirements for set-off were first satisfied, the amount in a client's transactional account was R100, but on the day the bank decides to enforce its right to apply set-off to recover the outstanding loan amounts, the balance has been reduced to R80 (after various deposits and withdrawals by the client). If it is accepted that set-off operates *ipso iure*, it would mean that the bank should reclaim all amounts withdrawn by the client after the date set-off could first operate with an enrichment claim. This leads to a further question: is it only in respect of the "missing" R20 that the bank needs to use the *condictio indebiti*, or in respect of the total of the amounts withdrawn by the client since set-off could first operate?

The Supreme Court of Appeal recently had the opportunity of clarifying these problems in *Standard Bank of South Africa Ltd v Echo Petroleum CC*.¹⁴⁶ In this case, a client had two accounts with the bank, one that had been overdrawn for some time and the other with a credit balance. The accounts were operated in this manner with varying credit and debit balances for some time. In June 2008, the bank issued demand for payment of the overdrawn account, thus rendering the full amount due and payable. After demand had been issued, the client continued to operate the accounts normally, with the credit balance in the second account frequently exceeding the debit balance in the first account.¹⁴⁷ In October 2008, the balance of the credit account once again exceeded the debit balance of the overdraft account, and the bank decided to apply

¹⁴⁵ *Alley Cat Clothing (Pty) Ltd v De Lisle Weare Racing* 2002 1 All SA 123 (D). See AJ Itzikowitz & SF du Toit "Banking and Currency" in WA Joubert (ed) *The Law of South Africa* 2(1) 2 ed (2006) para 343 for a discussion of the relationship between banks and their customers.

¹⁴⁶ 2012 5 SA 283 (SCA).

¹⁴⁷ Para 33.

set-off and to utilise the funds in the credit account to settle the debit balance of the other account.

Unfortunately, the court failed to analyse the operation of set-off in this context properly and merely held that the bank had acted lawfully in appropriating the funds. The following was said by Hefer JA with regard to the operation of set-off:

“Counsel for [the defendant], somewhat desperately, submitted that no set-off was possible in the absence of demand by the Bank for repayment of the debit amount on the [overdrawn] account. This, he conceded, had been made in June 2008, but he pointed out that the [credit] account had, between the date of demand and the receipt of Echo's deposit at the beginning of October, stood in credit in varying amounts that frequently exceeded the debit balance on the [overdrawn] account. This, he submitted, served as making the funds available for payment in satisfaction of the Bank's demand.

That the Bank chose not to appropriate the credits was of no significance; what was important was that a further demand became necessary in order to again render the [overdrawn] account due and payable. As no further demand was forthcoming the debit on that account could not be claimed by the bank and accordingly was not capable of set-off.

This seems to be a wholly artificial argument. When demand was made for payment of the [overdrawn] account the debit balance became due and payable. The Bank did not then or later (until 2 October) consolidate the accounts or apply set-off. The debt arising on the [overdrawn] account was never discharged and the demand stood. Although set-off occurs automatically by operation of law, it only operates retrospectively if and when the debtor (the Bank) elects to rely on it. See *Southern Cape Liquors (Pty) Ltd v Delipcus Beleggings Bpk* 1998 (4) SA 494 (C) at 499I – 501D and the authorities there cited. That election only took place on 2 October at a time when the [overdrawn] account remained unpaid and subject to the unsatisfied demand.”¹⁴⁸

As can be seen from the extract above, the court held that when demand was made, the debit balance became due and payable, and it is irrelevant that at times there were sufficient funds available to satisfy the bank's demand through set-off. This conclusion is irreconcilable with the view, seemingly acknowledged by Hefer JA, that set-off operates *ipso iure*. If set-off operated automatically, it would have extinguished the bank's claim in terms of the debit account the moment both debts became due and enforceable (provided the other requirements for set-off were met and there were no

¹⁴⁸ Paras 32-33.

contractual provisions to the contrary). In so far as set-off operated, the bank's claim was satisfied and the defendant did not have a right to the money in the credit account (as the defendant's claim had also been extinguished). To the extent that the bank 'repaid' a claim already discharged by set-off by allowing the defendant to withdraw money from the credit account, the bank was entitled to reclaim those amounts, possibly with the *condictio indebiti*. Thus, holding that "the debt arising on the [overdrawn] account was never discharged"¹⁴⁹ is completely at odds with the automatic operation of set-off.

The rather confusing statement by Hefer JA in the quote above that "[a]lthough set-off occurs automatically by operation of law, it only operates retrospectively if and when the debtor ... elects to rely on it", seems to conflate the second and fourth models to the operation of set-off.¹⁵⁰ It is therefore possible that the court instead opted for the minority view, namely that set-off operates retrospectively when it is declared. The decision in *Standard Bank of South Africa Ltd v Echo Petroleum CC*¹⁵¹ would be consistent with this approach. Because set-off in terms of the retrospective approach only operates once it is relied on, the fact that the credit balance exceeded the debit balance before such reliance would not cause the debt to be extinguished. Therefore, any payment made before the declaration would reduce the indebtedness of the defendant and thus the amount by which the debt can be reduced by set-off.¹⁵²

Theoretically, the retrospective operation of the declaration might also be problematic, because even though one of the requirements for set-off (i.e. a mutual debt) no longer exists, it existed sometime in the past and the defendant should still be allowed to rely on set-off, similar to where the debt was ceded. However, as mentioned above, the declaration cannot have an effect if the debt has since ceased to exist due to payment.¹⁵³ It is unanimously accepted by proponents of the retrospective view that only payments made after set-off was declared would constitute an undue payment.¹⁵⁴ The debtor (i.e. the bank) therefore has the option of paying the demand of the creditor

¹⁴⁹ Para 33.

¹⁵⁰ See the discussion in 3.3 above.

¹⁵¹ 2012 5 SA 283 (SCA).

¹⁵² Joubert *Law of Contract* 289.

¹⁵³ See 3.4.1 above.

¹⁵⁴ See De Wet & Van Wyk *Kontraktereg* 1 282; Joubert *Law of Contract* 289; Harms "Obligations" in *LAWSA* 19 para 245.

(i.e. the client) and preserving its own claim. This means that the bank can allow the client to withdraw funds from the account with the positive balance, and thereby preserve its claim in terms of the overdrawn account.

This scenario can be explained by the following example. A and B are mutually indebted, each owing the other R100. B repays his debt (after the debts were susceptible to set-off), but then becomes indebted to A again, this time for R80. Can set-off now operate in respect of the R80 debt incurred by B? If the *ipso iure* approach is adhered to it would appear not, since A's debt was extinguished when set-off could operate the first time. However, B still retains a claim against A for R100 (albeit now based on unjustified enrichment, since B paid an already extinguished debt) and this claim can be set off against B's new debt of R80. Should B wish to reclaim the R20 balance, he will have to do so by means of an enrichment action. However, if a declaration is required to effect set-off, the fluctuating indebtedness before such a declaration would have no effect. If B therefore decides to invoke set-off after he becomes indebted for the second time, he will be entitled to apply set-off in respect of the R80 and reclaim the outstanding R20 based on A's original indebtedness (which was never extinguished).

The example above can be applied in the context of a bank-client relationship, with A being in the position of the client and B being in the position of the bank. B's repayment consists of allowing A to withdraw funds from the credit account, and B will become indebted again (or become more indebted) if A deposits funds in that account. In other words, the client's (A's) claim against the bank (B) will decrease when funds are withdrawn by the client, and increase when money is deposited by him. The answer to the question posed earlier in this section, namely what the extent of B's enrichment claim would be, therefore depends on the approach which is followed. In terms of the retrospective approach, no enrichment claim will arise. In terms of the *ipso iure* approach however, the bank will be able to invoke set-off in respect of the available funds, but would have to rely on an enrichment claim to recover the balance.

Generally, in this context, the retrospective approach is preferable and applied more consistently with its theoretical principles. Clearly the *ipso iure* construction renders a result which is less desirable (because parties are not allowed the choice to keep their

claims alive)¹⁵⁵ and which is difficult to apply in practice. It is also probable that, in light of the conduct of the parties, such a result would be contrary to their intention. This can be inferred from the manner in which bank accounts are normally operated – both the bank and the client treat it as two distinct accounts until the bank effects set-off by transferring funds from the one account to the other.

Finally, it must also be added that the contractual arrangements between the parties may influence any reliance on set-off. The possibility of excluding or varying the effects of set-off will be discussed in the next chapter.¹⁵⁶

3 4 2 5 *Charging interest*

The status of payments made after the debts were susceptible to set-off highlights the practical difference between the two approaches to set-off. Conversely, the effect that both constructions have on the charging of interest illustrates the underlying problems caused by the notion, supported by both the *ipso iure* and retrospective approaches, that set-off operates at the moment it first becomes possible.

If set-off operates *ipso iure*, interest will cease to run from the moment the debts are in mutual existence,¹⁵⁷ because the debts will automatically terminate. If set-off operates retrospectively, any liability for interest on the debt after it became susceptible to set-off would automatically be terminated when set-off is declared or relied upon.¹⁵⁸

The practical problems that arise from set-off operating in either of these manners can again be illustrated by the relationship between a bank and its client.¹⁵⁹ Where set-off operates automatically, and in the absence of a contractual provision to the contrary, it would mean the bank would at all times only be allowed to charge interest on the overall balance of the amounts that are due and payable in respect of the two accounts. This is clearly contrary to the intention of both parties and the established *modus operandi* of the bank, who will continue to view the two accounts as separate and will

¹⁵⁵ De Wet & Van Wyk *Kontraktereg* 1 282.

¹⁵⁶ See ch 4 (4 2 3).

¹⁵⁷ Van der Merwe et al *Contract* 475; Joubert *Law of Contract* 289.

¹⁵⁸ Joubert *Law of Contract* 289.

¹⁵⁹ This relationship is discussed in more detail in ch 5 (5 2 2), but in the context of the National Credit Act 24 of 2005.

charge or pay interest on each account based on the balance of that account. As a result, the parties would presumably choose to regulate these matters contractually.

The situation is no less problematic if the view is taken that set-off operates retrospectively. In accordance with that view, once the bank decides to invoke its right to set-off, the amount of interest has to be adjusted retrospectively so that no interest is paid on that part of the loan which was susceptible to set-off.¹⁶⁰ The practical difficulties caused by this approach are obvious, even more so if one or both of the accounts is a transactional account in respect of which the debit or credit balance fluctuate continuously. Again the bank would probably elect to regulate this situation contractually.

The practical impact of either of the approaches in this context would be disastrous, taking into account the negative effect both constructions will have on the bank's revenue. This discrepancy between legal theory and commercial reality compels banks to introduce contractual provisions to remedy the situation. Possible drawbacks of relying on contractual provisions will be discussed in subsequent chapters.¹⁶¹

3 4 2 6 *Effect on default*

The effect set-off will have where a debtor defaults on his payment obligations (for example where loan payments are due but remain unpaid), whilst he has a claim against the creditor, also illustrates the inability of the current approaches to set-off to deal with modern relationships.

The automatic approach to the operation of set-off will cause a debtor's breach to be deemed never to have occurred,¹⁶² which will affect a creditor's reliance on an acceleration or cancellation clause in a loan agreement.¹⁶³ This was illustrated in *Southern Cape Liquors (Pty) Ltd v Delipcus Beleggings BK*,¹⁶⁴ where the lessee failed to pay his rent and the lessor cancelled the lease agreement based on this breach.

¹⁶⁰ Joubert *Law of Contract* 289; Pichonnaz & Gullifer *Set-Off in Arbitration*.

¹⁶¹ See ch 4 (4 2 3) for the possibility of varying the consequences of set-off contractually, and ch 5 for the impact of the National Credit Act 34 of 2005 on these types of contractual provisions.

¹⁶² Joubert *Law of Contract* 289; Van der Merwe et al *Contract* 475.

¹⁶³ This seems to be the position accepted by the court in *Great North Farms (Edms) Bpk v Ras* 1972 4 SA 7 (T).

¹⁶⁴ 1998 4 SA 494 (C).

However, the lessee had a claim against the lessor arising from the purchase of liquor by the latter from the former. After considering the principles surrounding the operation of set-off, the court held that the lessee's defence, namely that set-off nullified the lessor's claim and that the lessor was therefore not entitled to cancel the lease agreement, was good in law.¹⁶⁵

If the retrospective approach is followed, the debtor will be able to declare set-off and thereby cure his default retrospectively.¹⁶⁶ This can create "immeasurable difficulties"¹⁶⁷ for the creditor, who cannot be sure whether the debtor will rely on set-off. Any steps taken by the creditor pursuant to the breach, will then be made redundant, resulting in wasted costs and a possible cost order against the creditor. Although it can be argued that the creditor can also declare set-off and thereby avoid this uncertainty, there may be valid reasons why the creditor might prefer that set-off does not operate, for instance where a higher interest rate is charged on the debt owed to him.

At first glance, the *ipso iure* approach to set-off manages to avoid this "state of pendency ... before set-off has been declared"¹⁶⁸ and thus it would seem to result in greater certainty. However, it is commonly accepted that set-off will only operate when at least one of the parties desires and raises it.¹⁶⁹ The creditor is therefore faced with a similar problem to the one he is confronted with in terms of the retrospective approach: either he treats the non-payment as a breach and risks the possibility that the debtor later relies on the fact that set-off occurred automatically, or he must accept that set-off operated, not treat the debtor's default as a breach of the contract and thus lose the benefit of preserving his claim.

As with the other consequences of set-off, the parties can counter the uncertainty created in these circumstances by providing for it contractually.¹⁷⁰ However, it is evident that, should the parties fail to amend the situation by agreement, an uncertain

¹⁶⁵ 502. See the criticism against this judgment levelled by Scott 2006 TSAR 599-600.

¹⁶⁶ Joubert *Law of Contract* 289; Pichonnaz & Gullifer *Set-Off in Arbitration* 166.

¹⁶⁷ Joubert *Law of Contract* 289.

¹⁶⁸ Zimmermann *European Law of Set-Off* 40.

¹⁶⁹ *Hardy NO v Harsant* 1913 TPD 433 at 447.

¹⁷⁰ See chapter 4.

and therefore less than optimal situation will ensue, regardless of which approach is adhered to.

3 4 3 Assessment of the practical effects of the approaches to set-off

There are limited situations where the two approaches to the operation set-off will render different results. As seen above, the situations in which a different result would theoretically be achieved (keeping in mind that these approaches are often inconsistently applied in practice) depending on which approach is followed are: where there are multiple debtors or creditors; and where payments are made after the debts became susceptible to set-off.¹⁷¹ In both instances it has been shown that the view that a declaration is required for set-off to operate produces a more desirable outcome. It has further been seen that in both of these cases the consequences of the *ipso iure* approach are often deviated from, even by proponents of that view.

It is also evident that both approaches can lead to practically undesirable results. For example, we have seen that, with regard to interest charged after set-off could operate and the effect set-off has on default, neither approach corresponds with practical reality. It must be considered whether, as Scott states, we remain “verstrengel in die historiese onsekerhede van die verlede”¹⁷² and whether, in this regard, South African courts have failed to take notice of legal developments in other jurisdictions or modern private law doctrine.¹⁷³

To evaluate opinions like those of Scott, as well as the provisional conclusions above on the relative merits of the competing approaches, it may be helpful to consider the operation of set-off in other jurisdictions. The operation of set-off in civilian jurisdictions may provide particularly valuable insights into the problems faced in South African law, due to the shared legal background with regards to the development of set-off and the

¹⁷¹ A third possibility where the outcome would depend on the approach to set-off which is adhered to is where the debt is prescribed. However, the principles applicable in such an instance is unclear (see 3 4 1 above).

¹⁷² “Entangled in the historical uncertainties of the past” (own translation) - Scott 2006 *TSAR* 601.

¹⁷³ 601.

influence of Roman and Roman-Dutch sources on the application of set-off both in South Africa and Europe.¹⁷⁴

3 5 Operation of set-off in civil law jurisdictions

Civilian jurisdictions can be divided into two broad groups with regards to their approach to set-off.¹⁷⁵ The first group, which includes France¹⁷⁶ and Belgium,¹⁷⁷ accepts the *ipso iure* operation of set-off, but requires it to be raised in court; the second, which includes Germany and the Netherlands,¹⁷⁸ requires set-off to be raised, but then usually qualifies this requirement by accepting that once raised, set-off operates retrospectively. Like the two approaches accepted in South African law, these correspond with the second and fourth theoretical approaches to set-off identified by Zimmermann.¹⁷⁹

3 5 1 Civil law jurisdictions that attribute an *ipso iure* effect to set-off

The Romanistic legal systems, such as French and Belgian law, based their approach to set-off on the view of Pothier¹⁸⁰ and thus provide that set-off operates automatically.¹⁸¹ French law unequivocally states that debts are extinguished *ipso iure* as soon as they are capable of set-off.¹⁸² Article 1290 of the French Civil Code (*Code Civil*) reads as follows:

¹⁷⁴ Scott 2006 TSAR 595, 599; R Zimmermann *The Law of Obligations: Roman Foundations of the Civilian Tradition* (1990) 760-761.

¹⁷⁵ Zimmermann *Obligations* 760; R Zimmermann "Ius Commune and the Principles of European Contract Law - Contemporary Renewal of an Old Idea" in HL MacQueen & R Zimmermann (eds) *European Contract Law: Scots and South African Perspectives* (2006) 1 29; R Zimmermann "The Civil Law in European Codes" in H MacQueen, A Vaquer & SE Espiau (eds) *Regional Private Laws and Codification in Europe* (2003) 18 40.

¹⁷⁶ French law is especially important in the South African context (Van Niekerk 1968 SALJ 35). Also see *Adjust Investments (Pty) Ltd v Wiid* 1968 3 SA 29 (O) 31-32: "The development of our law of set-off ... [has] received its impetus not from the Romans but the Dutch and the French."

¹⁷⁷ Lando et al *European Contract Law* 149; R Zimmermann "Legal History and Comparative Law" (25-10-2007) *Universitat de Lleida* 5 <http://www.udl.es/export/sites/UdL/organs/secretaria/honoris/zimmermann_discurs.pdf> (accessed 30-11-2015); Scott 2006 TSAR 599.

¹⁷⁸ Lando et al *European Contract Law* 149; Zimmermann "Legal History and Comparative Law" *Universitat de Lleida* 5; Scott 2006 TSAR 599; Zimmermann "The Civil Law in European Codes" in *Private Laws in Europe* 41.

¹⁷⁹ See 3 3 above.

¹⁸⁰ See ch 2 (2 4 1).

¹⁸¹ Art 1290 French Civil Code (*Code civil*); Art 1289 of the Belgian Civil Code.

¹⁸² Zimmermann *Obligations* 760-761.

“Set-off is brought about as of right by the sole operation of the law, even without the knowledge of the debtors; the two debts are reciprocally extinguished, from the moment when they happen to exist at the same time, to the extent of their respective amounts.”¹⁸³

Theoretically, set-off thus operates irrespective of the will of the parties.¹⁸⁴ However, French courts have found it impractical to implement this provision strictly¹⁸⁵ due to the “doctrinal anomaly that an automatic discharge of an obligation may not automatically be taken into account in judicial proceedings involving this obligation.”¹⁸⁶ Set-off is therefore held to be effective only if the defendant raises it in court¹⁸⁷ and as a result the automatic operation of set-off is subject to the condition that set-off is pleaded in court as a defence.¹⁸⁸ As mentioned above, this approach corresponds with the second model of set-off.¹⁸⁹

Inevitably, this condition has resulted in the will of one of the parties being decisive in order for set-off to operate,¹⁹⁰ since a court cannot take set-off into account *mero motu*.¹⁹¹ It has further caused set-off in terms of this regime to closely resemble the approach in other civilian systems which require a declaration. However, the solution causes French law to be more restrictive than the approach requiring a declaration, for it requires that the matter must serve before a court before set-off can be raised.¹⁹² Zimmermann criticises this unnecessary restriction and argues that:

¹⁸³ Translation by G Rouhette “Civil Code” (04-04-2006) *Legifrance* <www.legifrance.gouv.fr/content/download/1950/13681/.../Code_22.pdf> (accessed 30-11-2015).

¹⁸⁴ Zimmermann *Obligations* 761; C Fountoulakis *Set-Off Defences in International Commercial Arbitration: A Comparative Analysis* (2011) 8.

¹⁸⁵ Zimmermann “Ius Commune” in *European Contract Law* 23-24; Zimmermann *European Law of Set-Off* 25; Lando et al *European Contract Law* 149 n1.

¹⁸⁶ Zimmermann *European Law of Set-Off* 34-35.

¹⁸⁷ Zimmermann *European Law of Set-Off* 25; Lando et al *European Contract Law* 149 n 1; Pichonnaz & Gullifer *Set-Off in Arbitration* 28.

¹⁸⁸ Zimmermann *European Law of Set-Off* 25; Lando et al *European Contract Law* 149 n 1; Pichonnaz “*Compensatio*” in *Principles of European Contract Law* 287.

¹⁸⁹ See 3 3 above.

¹⁹⁰ Zimmermann “Ius Commune” in *European Contract Law* 24; R Zimmermann “Set-Off” in J Basedow, Hopt KJ, R Zimmermann & A Stier (eds) *The Max Planck Encyclopedia of European Private Law II* (2012) 1554 1555.

¹⁹¹ Jauffret-Spinosi “UNIDROIT 2000 Study L – Doc 62 bis: Position Paper” *UNIDROIT* 3, 5.

¹⁹² Zimmermann *European Law of Set-Off* 35.

“if set-off aims to avoid circuity of action and multiplicity of suits, a solution is arguably preferable which, at least occasionally, avoids a lawsuit altogether, rather than making the effect of set-off depend upon legal proceedings having been instituted.”¹⁹³

French courts have tried to rationalise the situation where the law regards set-off to have operated automatically, but the failure to invoke it meant that set-off could not operate in practice. Their solution is to impute a waiver on the part of the defendant of his right to rely on set-off.¹⁹⁴ This explanation is very unsatisfactory, especially where the defendant was unaware that set-off could operate, as it distorts the concept of waiver.¹⁹⁵ It is, in other words, a fiction relied on to explain the discrepancy between the theory and the practical application.

Another anomaly in French law is Article 1299 of the *Code Civil*, which only grants the *condictio indebiti* to a person who pays a debt which was susceptible to set-off if he had a valid reason for not being aware of the operation of set-off (i.e. if it was an excusable mistake). In other cases, the original claim will remain enforceable, which is irreconcilable with the automatic operation of set-off.¹⁹⁶ This is an indication that set-off as a method of debt extinction depends upon the intention of the parties. Where a party pays an amount knowing that set-off could operate, that party is deemed to have waived his right to set-off.¹⁹⁷

It is evident that, despite article 1290 of the *Code Civil* leaving no doubt that set-off operates without the consent or the knowledge of the parties, it is actually treated more like a right which a party has to invoke. Therefore, a party is able to waive this right¹⁹⁸ – something which would not have been possible if set-off operated independently of the parties’ wills.

Like South African law, French law further requires that both debts must be liquid.¹⁹⁹ This emanates from the *ipso iure* effect attributed to set-off in French law, since

¹⁹³ 35.

¹⁹⁴ Zimmermann *European Law of Set-Off* 35; Pichonnaz & Gullifer *Set-Off in Arbitration* 28.

¹⁹⁵ Zimmermann *European Law of Set-Off* 35.

¹⁹⁶ Zimmermann *European Law of Set-Off* 37; Scott 2006 *TSAR* 598.

¹⁹⁷ Pichonnaz & Gullifer *Set-Off in Arbitration* 142; Scott 2006 *TSAR* 598.

¹⁹⁸ Pichonnaz & Gullifer *Set-Off in Arbitration* 142.

¹⁹⁹ Art 1291 *Code Civil*; Zimmermann *European Law of Set-Off* 52; Pichonnaz & Gullifer *Set-Off in Arbitration* 143-144. An exception is made in the case of connected or interrelated debts, see De Pardieu & Hubert “France” in *Set-Off Law and Practice* 162.

otherwise it would be impossible to calculate the extent to which the debts extinguished each other.²⁰⁰ It is also required that both debts are enforceable.²⁰¹

Set-off in the context of cession is specifically provided for in Article 1295 of the *Code Civil*. Before notice of cession is given to the debtor, he is allowed to claim set-off against a cessionary in respect of claims he has against the cedent. If the cession is accepted by the debtor, it is understood that he has waived his right to rely on set-off of any claims he has against the cedent.²⁰² If the debtor does not accept the cession, he will be allowed to set off a debt owed by the cedent and which arose before the cession, but not claims which arose after notice of the cession was given.²⁰³

Special rules also surround the operation of set-off upon the occurrence of insolvency in French law. These are not relevant for present purposes, save to state that they are regulated in the context of bankruptcy law.²⁰⁴

A similar position has been adopted by Belgian courts, where, despite the Belgian Civil Code providing for automatic set-off, the defendant is required to raise it as a defence.²⁰⁵ Waiver of the application of set-off is also allowed in Belgian law, although it is required that such a waiver be made expressly.²⁰⁶

3 5 2 Civil law jurisdictions that require a declaration before set-off may operate German law provides a good example of a legal system falling into the second category (and thus the fourth approach identified by Zimmermann),²⁰⁷ namely that set-off requires a declaration to come into effect.²⁰⁸ This approach, which resulted from the

²⁰⁰ Lando et al *European Contract Law* 145.

²⁰¹ C Jauffret-Spinosi "UNIDROIT 2001 Study L – Doc 72: Draft chapter" (2001) *UNIDROIT* 16 <<http://www.unidroit.org/english/documents/2001/study50/s-50-071-e.pdf>> (accessed 30-11-2015).

²⁰² Scott 2006 *TSAR* 598.

²⁰³ Art 1295 *Code Civil*; Pichonnaz & Gullifer *Set-Off in Arbitration* 143-144.

²⁰⁴ De Pardieu & Hubert "France" in *Set-Off Law and Practice* 163.

²⁰⁵ Vermeylen "Belgium" in *Set-Off Law and Practice* 51.

²⁰⁶ 51.

²⁰⁷ See 3 3 above.

²⁰⁸ Zimmermann *Obligations* 760; Zimmermann *European Law of Set-Off* 33. This approach seems to be the one adopted by the majority of European legal systems - see Lando et al *European Contract Law* 149 n 1.

developments of the Pandectists,²⁰⁹ is embodied in Articles 387 to 389 of the German Civil Code (*Bürgerliches Gesetzbuch*). These provisions read as follows:

“If two persons owe each other performance that is substantially of the same nature, each party may set off his claim against the claim of the other party as soon as he can claim the performance owed to him and effect the performance owed by him.

Set-off is effected by declaration to the other party. The declaration is ineffective if it is made subject to a condition or a stipulation as to time.

The effect of set-off is that the claims, to the extent that they correspond, are deemed to expire at the time when they are set against each other as being appropriate for set-off.”²¹⁰

An informal declaration out of court is sufficient to effect set-off under German law.²¹¹

A party is able to declare unilaterally that his debt is extinguished by set-off and no particular formality is prescribed for the notice.²¹² A party is also not obliged to invoke set-off – it is a voluntary act.²¹³

The effect of set-off in German law is retrospective.²¹⁴ As in South African law, history provides the only explanation for this peculiarity²¹⁵ namely that it developed in an attempt to reconcile the view that set-off must be effected by means of a declaration with the *ipso iure* approach.²¹⁶

Nevertheless, all the requirements for set-off must be met at the time a party seeks to rely on it; in other words, set-off will not operate if all the requirements were met at a time in the past but not at the time when a party elects to rely on it.²¹⁷ Therefore, in terms of German law, if a debt is ceded before set-off is invoked, a party will theoretically be precluded from setting that debt off against a debt owed to him by the

²⁰⁹ See ch 2 (2 4 3).

²¹⁰ Translated by Langenscheidt Translation Service “German Civil Code” (2014) *Bundesminister der Justiz und für Verbraucherschutz* <http://www.gesetze-im-internet.de/englisch_bgb/englisch_bgb.html#p1423> (accessed 30-11-2015).

²¹¹ Zimmermann “Ius Commune” in *European Contract Law* 23.

²¹² Jauffret-Spinosi “UNIDROIT 2000 Study L – Doc 62 bis: Position Paper” *UNIDROIT* 3.

²¹³ 5.

²¹⁴ Zimmermann *European Law of Set-Off* 33; Pichonnaz & Gullifer *Set-Off in Arbitration* 138.

²¹⁵ Zimmermann “Set-Off” in *The Max Planck Encyclopedia* 1555; Pichonnaz & Gullifer *Set-Off in Arbitration* 165.

²¹⁶ Zimmermann “Set-Off” in *The Max Planck Encyclopedia* 1555.

²¹⁷ Zimmermann *European Law of Set-Off* 36-37.

cedent. Consequently, Articles 404²¹⁸ and 406²¹⁹ of the German Civil Code specifically provide protection for the debtor where the debt is ceded before set-off is effected, but after the debt became susceptible to set-off.

A similar approach has been accepted in the new Dutch Civil Code (*Burgerlijk Wetboek*)²²⁰ and the Swiss Federal Code of Obligations (*Code des Obligations*).²²¹ Both the Netherlands and Swiss law require a declaration, upon which set-off has a retrospective effect to the date it first became possible.²²² However, the Dutch Civil Code restricts the retrospective effect of set-off, in that interest which has already been paid in respect of the debts are not adjusted retrospectively.²²³

In Swiss law, as in German law, no formalities are prescribed for the declaration.²²⁴ It is not even required that the declaration be made expressly; a tacit declaration will also suffice.²²⁵ Similar to the provision made for set-off under German law in the case of a cession, Articles 169 and 170 of the *Code des Obligations* provide that a debtor may still rely on set-off if it was possible before notice of the cession was received by the debtor.²²⁶

Swiss law does not impose liquidity as a requirement for set-off and article 120(2) of the *Code des Obligations* specifically states that:

“The debtor may assert his right of set-off even if the countervailing claim is contested.”²²⁷

²¹⁸ “The obligor may raise against the new obligee the objections that he was entitled to raise against the previous obligee at the time of assignment.” (Translated by Langenscheidt Translation Service “German Civil Code” *Bundesminister der Justiz und für Verbraucherschutz*).

²¹⁹ “The obligor may set off a claim against the previous obligee to which he is entitled against the new obligee as well, unless, when acquiring the claim, he was aware of the assignment or the claim only became due after he obtained knowledge of this and later than the assigned claim became due.” (Translated by Langenscheidt Translation Service “German Civil Code” *Bundesminister der Justiz und für Verbraucherschutz*).

²²⁰ Arts 6:127(1) and 6:129.

²²¹ Art 124.

²²² Pichonnaz 2000 *TR* 541; Scott 2006 *TSAR* 598; R Bösch & C Amstutz “Switzerland” in Johnston W & Werlen T *Set-Off Law and Practice: An International Handbook* (2006) 433 437.

²²³ Art 129:2 Dutch Civil Code; Zimmermann *European Law of Set-Off* 41 n 110.

²²⁴ Bösch & Amstutz “Switzerland” in *Set-Off Law and Practice* 437.

²²⁵ 437.

²²⁶ 436.

²²⁷ Translated by Federal Council of Switzerland “Code of Obligations” (2015) *Swiss Federation* <<https://www.admin.ch/opc/en/classified-compilation/19110009/201507010000/220.pdf>> (accessed 30-11-2015).

German law subscribes to a similar notion and the liquidity of the counterclaim is not prescribed for set-off to operate.²²⁸ In other words, a party may have his counterclaim discharged without knowing the precise amount of it.²²⁹ This leads to the peculiar situation in both German and Swiss law where a judge later adjudicates on the amount of the counterclaim, however

“set-off will operate with these claims as though they have been ascertained as to their existence and to their amount from the first day of coexistence!”²³⁰

German and Dutch law do not require that the main claim has to be enforceable, only the cross-claim (i.e. the debt owed to the person seeking to invoke set-off).²³¹ Although Article 120(1) of the *Code des Obligations* implies that both debts should be due, in practice it is sufficient if only the claim due to the person declaring set-off is due and enforceable; the main claim is only required to be payable.²³²

All three legal systems have special provisions dealing with set-off in the context of insolvency.²³³ German and Swiss law further provides protection for a surety where the debt between the creditor and principal debtor is susceptible to set-off. Although the surety cannot declare set-off, the debt cannot be claimed from him to the extent set-off can operate between the creditor and principal debtor.²³⁴

3 5 3 Assessment of the operation of set-off in civil law jurisdictions

Both the Romanistic and Germanistic legal systems have been unable to resolve the problematic notions of set-off inherited from Roman law and are therefore faced with

²²⁸ Jauffret-Spinosi “UNIDROIT 2001 Study L – Doc 72: Draft chapter” (2001) *UNIDROIT* 14; Pichonnaz & Gullifer *Set-Off in Arbitration* 138.

²²⁹ Pichonnaz & Gullifer *Set-Off in Arbitration* 138.

²³⁰ 138.

²³¹ Jauffret-Spinosi “UNIDROIT 2001 Study L – Doc 72: Draft chapter” *UNIDROIT* 16; H Haag & K Birke “Germany” in W Johnston & T Werlen *Set-Off Law and Practice: An International Handbook* (2006) 173 175; W Rank & L Silverentand “The Netherlands” in W Johnston & T Werlen *Set-Off Law and Practice: An International Handbook* (2006) 285 286; Böhlhoff & Budde 1984 *Int’l Fin L Rev* 30. This is in line with the view advanced by De Wet and Van Wyk that the creditor’s claim does not need to be due and enforceable (see the discussion at 3 2 above).

²³² Bösch & Amstutz “Switzerland” in *Set-Off Law and Practice* 435.

²³³ For Germany see Haag & Birke “Germany” in *Set-Off Law and Practice* 176-179; Böhlhoff & Budde 1984 *Int’l Fin L Rev* 31-32. For the Netherlands see Rank & Silverentand “The Netherlands” in *Set-Off Law and Practice* 287-293. For Switzerland see Bösch & Amstutz “Switzerland” in *Set-Off* 438-441.

²³⁴ Art 770 of the German Civil Code; Art 121 of the *Code des Obligations*; Pichonnaz & Gullifer *Set-Off in Arbitration* 189-190.

the same problems experienced in South African law. They also regard the obligations as extinguished at the moment that they are susceptible to set-off, either because they attribute an *ipso iure* operation to set-off or because, once it is declared, set-off is held to have retrospective effect.²³⁵ As a result, the consequences of set-off are largely the same as they would be in South African law.²³⁶

Similar to the experience in South African law, neither of the two approaches to set-off followed in civil law jurisdictions provide a logical and sensible solution to the problems surrounding set-off. It is further apparent that in terms of both approaches a whole range of exceptions exists in all legal systems.²³⁷ Two prime examples are French law which, despite accepting the automatic operation of set-off, still requires a declaration²³⁸ and Dutch law which, despite attributing a retrospective effect to the declaration of set-off, provides that interest already paid does not need to be repaid.²³⁹

3 6 Evaluation of the approaches to set-off adopted in South African law

Having considered the approaches adopted in some civil law jurisdictions, the two approaches to set-off followed in South African law can now be evaluated in the light of the policy considerations informing them and the practical impact they have on commercial relationships.

There are policy considerations supporting both approaches to the operation of set-off. Van Niekerk contends that the *ipso iure* approach promotes certainty, because it determines more precisely the moment when set-off takes effect.²⁴⁰ He is further of the opinion that “it is in accordance with public policy that debts should be settled at the earliest date possible and that a multiplication of claims between the same parties should be avoided”.²⁴¹ He also argues that in most cases it is in line with the intentions of the parties that the debts extinguish each other as soon as it is possible,²⁴² i.e. automatic set-off is in accordance with their deemed intention. Other policy reasons

²³⁵ Zimmermann *European Law of Set-Off* 36.

²³⁶ For a summary of the consequences, see Zimmermann *European Law of Set-Off* 37.

²³⁷ Zimmermann *European Law of Set-Off* 38; Jauffret-Spinosi “UNIDROIT 2000 Study L – Doc 62 bis: Position Paper” *UNIDROIT* 4.

²³⁸ See 3 5 1 above.

²³⁹ See 3 5 2 above.

²⁴⁰ Van Niekerk 1968 *SALJ* 36.

²⁴¹ 36.

²⁴² 36.

advanced for the *ipso iure* approach include the notion that protection must be granted to parties who are in a position to invoke set-off.²⁴³

However, Van der Merwe and others recognise that:

“[r]equiring a reliance on set-off will not necessarily create uncertainty or result in a multiplicity of actions, nor is it immediately apparent that whatever public interest there may be in the earliest possible extinction of debts outweighs the need to recognise the autonomy of the parties in this regard.”²⁴⁴

The fundamental weakness of the *ipso iure* approach lies in its inconsistency with the autonomy contracting parties enjoy under our law. The latter principle has led to the almost unanimous agreement, even by proponents of the *ipso iure* approach, that set-off should not operate where neither of the parties wishes it.²⁴⁵ This dependency of set-off on the will of the parties was already recognised by Justinian.²⁴⁶ However, granting the parties an election on whether set-off operates undermines the core principle of the *ipso iure* approach and “reduce[s] it to an artificial theoretical construction”.²⁴⁷ This has also been the experience in other jurisdictions attributing an automatic effect to set-off where, despite provisions to the contrary, it is ultimately the will of the parties which is decisive.²⁴⁸ In order to preserve contractual autonomy, all legal systems that subscribe to this approach have adopted rules which are inconsistent with the *ipso iure* operation of set-off. French law provides a good example of this.²⁴⁹ It is submitted that this conflict between autonomy and the *ipso iure* approach enhances uncertainty, rather than promoting certainty.

Also problematic in terms of the view that set-off operates automatically is a situation where the defendant fails to raise the defence of set-off. This gives rise to the paradoxical state of affairs that set-off took place automatically in theory, but is not

²⁴³ Zimmermann *European Law of Set-Off* 39; Zimmermann “Set-Off” in *The Max Planck Encyclopedia* 1556.

²⁴⁴ *Contract* 474.

²⁴⁵ On authority of Voet *Commentarius ad Pandectas* 16 2 2, 16 2 6. See *Southern Cape Liquors (Pty) Ltd v Delipcus Beleggings BK* 1998 4 SA 494 (C); *Hardy NO v Harsant* 1913 TDP 433; Van der Merwe et al *Contract* 470; Christie & Bradfield *Law of Contract* 495.

²⁴⁶ For instance *D* 16 2 2. See the discussion in ch 2 (2 3 and 2 4 4).

²⁴⁷ Van der Merwe et al *Contract* 474.

²⁴⁸ See n 190 above.

²⁴⁹ See 3 5 1 above.

raised and therefore is not given effect to in practice.²⁵⁰ The result of this could be that a court gives judgment on a debt that the law regards as no longer in existence. The solution found in other jurisdictions, such as France, which regard it as a waiver of the party's right is unsatisfactory, because it disregards the principles of both the automatic operation of set-off and the notion of waiver.²⁵¹

Lastly, the *ipso iure* approach is inconsistent with commercial reality. In most cases, until set-off is raised by either party, a creditor will continue to view his debtor as indebted to him and accept settlement of the debt by payment. A creditor will also often still attempt to collect payment or even institute legal proceedings for recovery of the debt. For example, a bank will treat two accounts of the same client (the one standing to his credit and the other having a debit balance) as separate accounts, until the bank decides to rely on set-off and appropriate money from the one account to decrease or settle the debit balance of the other account. In practice therefore, set-off will only have an effect when at least one of the parties relies on it. This also indicates that it is not necessarily the intention of the parties that set-off should operate as soon as the requirements for it are fulfilled.²⁵²

Requiring a declaration to effect set-off manages to circumvent the biggest problems faced by the *ipso iure* construction. This view is supported by various authors,²⁵³ on the basis that it ensures more legal certainty and acknowledges the autonomy of the parties.²⁵⁴ It allows a party to keep his claim alive by making payment and to enforce it by way of action.²⁵⁵

Furthermore, if an approach is adopted in terms of which a declaration of set-off is a requirement for it to take effect, De Wet and Van Wyk's argument that only the debt raised in set-off needs to be enforceable and liquid can be sustained. As discussed above,²⁵⁶ where a declaration is required for set-off to operate, the debtor is enforcing his claim and discharging the creditor's claim. It can thus be argued that the creditor's

²⁵⁰ Christie & Bradfield *Law of Contract* 495.

²⁵¹ Also see 3 5 1 above.

²⁵² Zimmermann *European Law of Set-Off* 39 n 102.

²⁵³ De Wet & Van Wyk *Kontraktereg* 1 282-283; Van der Merwe et al *Contract* 520-521; Zimmermann *European Law of Set-Off* 32-36; Scott 2006 *TSAR* 597.

²⁵⁴ Scott 2006 *TSAR* 597; Van der Merwe et al *Contract* 474.

²⁵⁵ Van der Merwe et al *Contract* 473; De Wet & Van Wyk *Kontraktereg* 1 282.

²⁵⁶ See 3 2 above.

claim does not need to be due and enforceable, merely payable. Furthermore, it should be sufficient if only the debtor's claim is liquid – he can choose to set it off against any amount he may owe the creditor. However, the rationale behind these arguments disappears where set-off operates automatically, since set-off does not depend on the election of either party. Relaxing the requirements for set-off in this manner will not only facilitate set-off and promote fairness, but will also be more in line with the general principles of performance.²⁵⁷

An argument relating to the release of a surety can be made against requiring a declaration for set-off to operate. If set-off operates *ipso iure*, he is freed from the earliest moment. In such a case the parties will not be allowed exclude the operation of set-off, as it will place an impermissible burden on the surety.²⁵⁸ However, if a declaration by one of the parties is required to invoke set-off, a surety may be prevented from claiming release based on set-off. Despite this, South African law allows a surety to rely on set-off between the principal debtor and the creditor.²⁵⁹ This is not in line with the minority view of set-off, but could be justified based on the accessory nature of the surety's liability.²⁶⁰

There are persuasive arguments for the view that requiring a declaration is preferable from both a theoretical and practical point of view. However, the retroactive effect attributed to the declaration creates uncertainty and practical difficulties. This is especially apparent when considering the effect of set-off on interest charged prior to the declaration, and its effect where one party was in default, but he failed to declare set-off timeously. Joubert argues that the uncertainty created and the accompanying difficulties for the creditor due to the retrospective effect of the declaration (for example the fact that a breach of contract or a claim for interest can be nullified retrospectively) is of such severity that, despite the problems with the *ipso iure* approach, the balance of convenience still favours it.²⁶¹

²⁵⁷ De Wet & Van Wyk *Kontraktereg* 1 278, 280-282.

²⁵⁸ Van Niekerk 1968 *SALJ* 37. However, see the discussion of *Dominick v Nedbank Limited* (20463/14) 2015 ZASCA 160 (13 November 2015) in ch 4 (4 2 2 1).

²⁵⁹ See 3 2 above.

²⁶⁰ Van der Merwe et al *Contract* 471.

²⁶¹ *Law of Contract* 289.

Historically, the notion of retroactivity developed in an attempt to reconcile the view that a declaration is required to effect set-off with the *ipso iure* approach.²⁶² It was discussed previously why this historical basis may be regarded as flawed.²⁶³ Policy reasons advanced for attributing a retrospective effect to set-off are that the debtor usually does not declare set-off until he is sued by the creditor, and that it is necessary to protect any belief he may have had from the moment the requirements for set-off were met that he is no longer indebted.²⁶⁴ Pichonnaz mentions three reasons why this reasoning is not sound.

First, both debts would only be discharged if the claims are for the same amount.²⁶⁵ However, in practice, the respective debts are usually not for the same amount, which means that there may be an outstanding debt due by one of the parties. In the latter case, there is no reason for a debtor to believe that the respective obligations have been (completely) extinguished by virtue of set-off. Therefore, in most cases, the policy consideration underlying the retrospective effect attributed to a declaration of set-off (i.e. to protect the debtor's belief that he does not owe anything) is largely irrelevant.

Secondly, in a system where a declaration in the form of a notice of set-off is required, the claims are unaffected before such a declaration is made. The view that the claims are already affected in some way, and that the debtor is therefore entitled to some protection even before set-off is declared (for example by accepting that he cannot be in default if set-off could have operated), stems from the automatic approach to set-off and does not fit in with a system where set-off is a voluntary act.²⁶⁶ There is no reason to protect the debtor before notice of set-off is given, since it is usually simple and convenient for him to declare set-off.²⁶⁷ It can further be argued that it is merely a fiction that most debtors would believe that set-off has operated automatically once the

²⁶² See ch 2 (2 4 2).

²⁶³ See ch 2 (2 4 4).

²⁶⁴ These played a role in the formulation of the approach in both German and Dutch law (Pichonnaz 2000 *TR* 560; Böhlhoff & Budde 1984 *Int'l Fin L Rev* 32; Zimmermann "Set-Off" in *The Max Planck Encyclopedia* 1556).

²⁶⁵ Pichonnaz 2000 *TR* 560.

²⁶⁶ 560-561.

²⁶⁷ Zimmermann "Set-Off" in *The Max Planck Encyclopedia* 1556-1557.

requirements are met, and that there is no justification for protecting this fictional belief. As Zimmermann rightly states:

“If it were true that whoever is in a position to give notice of set-off no longer regards himself as debtor and thus relies on not having to make payment, this argument would favour set-off *ipso iure* rather than a retroactive one”.²⁶⁸

Lastly, it is preferable for the debtor to declare set-off as soon as possible rather than to wait until action is instituted before he does so.²⁶⁹ If an informal declaration is required, such a declaration will be easily achieved and there is thus no reason for the debtor to delay.²⁷⁰ Denying retrospective effect to set-off would encourage a debtor to declare set-off as soon as possible. This would enhance certainty and avoid unnecessary legal actions. Practical problems could arise where the debtor is unaware that set-off has to be declared, but since an informal declaration will suffice, it is not unreasonable to expect him to inform the creditor that he no longer regards himself as indebted.²⁷¹

Evidently, both the *ipso iure* and retrospective approaches fall short of ensuring legal certainty and preventing unnecessary costs. In terms of both the approaches, it is necessary to determine when set-off first became possible. This can cause an unnecessarily protraction of a case before the court: instead of merely looking at the debts as they stand, the court now has to take note of evidence proving at what time the debts met the requirements for set-off, including at what stage they became due and liquid. This could conceivably be a difficult task and could delay the speedy resolution of the matter, thereby bringing about the exact mischief the liquidity requirement aims to avoid.²⁷²

The legal principles on which both approaches are founded and which originated in much simpler times, are clearly incapable of dealing with complex modern relationships. To counter this uncertainty, we may have to consider the proposal, *inter alia* favoured by Zimmermann, that we should “adopt a rule according to which the

²⁶⁸ Zimmermann *European Law of Set-Off* 39 n 102, with reference to S Dullinger *Handbuch der Aufrechnung* (1995) 180f.

²⁶⁹ Zimmermann “Set-Off” in *The Max Planck Encyclopedia* 1557.

²⁷⁰ Pichonnaz 2000 *TR* 561.

²⁷¹ This is discussed in more detail in ch 6 (6.3).

²⁷² Zimmermann *European Law of Set-Off* 52.

notice of set-off leads to a discharge *pro tanto* of the obligations confronting each other”.²⁷³ This proposal, which is in line with the approach recommended by the PICC and PECL, will now be considered.

3 7 Attempts at unification: PICC and PECL

With the formation of the European Union and the increase in trade between the member states, greater support for a unified European private law has recently started emerging²⁷⁴ (albeit that the recent attempts at creating a common European Sales Law have not come to fruition).²⁷⁵ Several initiatives have been undertaken to facilitate this process.²⁷⁶ Most notably are the PECL, which were drafted by the Commission of the European Contract Law,²⁷⁷ and the PICC, which are a set of principles with a more global scope and were prepared by the International Institute for the Unification of Private Law (UNIDROIT).²⁷⁸

There is a great degree of similarity between the principles regarding set-off in the PICC and the PECL, which may be explained by the fact that the two instruments were drafted more or less at the same time²⁷⁹ and the close personal ties between the respective commissions responsible for the drafting.²⁸⁰ Essentially, the respective provisions on set-off follow the German model of set-off by notice, but attribute a prospective effect to such notice.²⁸¹ Both sets of principles therefore adopt the fifth theoretical construction of the operation of set-off identified above.²⁸² This is in spite of the fact that most civil law jurisdictions regard the debts to be discharged from the

²⁷³ 41.

²⁷⁴ 1.

²⁷⁵ E Clive “Proposal for a Common European Sales Law withdrawn” (07-01-2015) *European Private Law News* <<http://www.epln.law.ed.ac.uk/2015/01/07/proposal-for-a-common-european-sales-law-withdrawn/>> (accessed 01-12-2015).

²⁷⁶ Zimmermann *European Law of Set-Off* 2-3; Pichonnaz & Gullifer *Set-Off in Arbitration* 170.

²⁷⁷ European Commission on European Contract Law *The Principles of European Contract Law (PECL)* 2002; Zimmermann *European Law of Set-Off* 4.

²⁷⁸ See International Institute for the Unification of Private Law *UNIDROIT Principles of International Private Law 2010*; S Vogenauer (ed) *Commentary on the UNIDROIT Principles of International Commercial Contracts (PICC)* 2 ed (2005); R Zimmermann “The UNIDROIT Principles of International Commercial Contracts 2004 in Comparative Perspective” 2006 *Tul Eur & Civ LF* 1.

²⁷⁹ P Pichonnaz “Set-Off” in S Vogenauer (ed) *Commentary on the UNIDROIT Principles of International Commercial Contracts (PICC)* 2 ed (2005) 1033 1035.

²⁸⁰ Zimmermann 2006 *Tul Eur & Civ LF* 6; Pichonnaz & Gullifer *Set-Off in Arbitration* 170.

²⁸¹ Arts 13:104 & 13:106 PECL; Arts 8.3 & 8.5 PICC; Zimmermann 2006 *Tulane European & Civil Law Forum* 20-21.

²⁸² See 3 3 above.

moment they first become susceptible to set-off,²⁸³ because they opt for either the *ipso iure* or retrospective approach.

The approach requiring a notice of set-off was supported for various reasons. Requiring a voluntary declaration of set-off recognises the idea that obligations are discharged because of the will of the parties.²⁸⁴ The declaration serves to inform the one party of the other's intent²⁸⁵ and therefore enhances certainty. It is thus considered to be preferable to the business community.²⁸⁶ There also seems to be a convergence of all systems towards set-off by notice:²⁸⁷ notice is a requirement in a large number of jurisdictions such as German, Swiss and Dutch law, and even jurisdictions such as France ultimately require set-off to be raised, albeit during the course of judicial proceedings.²⁸⁸ A benefit of requiring an extrajudicial notice is the fact that the notion that set-off needs to be declared before a judge is dismissed.²⁸⁹ This prevents a declaration of set-off from being postponed until action is instituted, and further avoids unnecessary legal costs. As stated by Pichonnaz and Gullifer:

“Set-off triggered by extrajudicial notice is economically more efficient than an automatic set-off regime and, doctrinally, more coherent with the idea that the obligations are discharged because of the will of one party.”²⁹⁰

After deciding that a notice of set-off will be required for set-off to be effected, the retroactive effect attributed to set-off in terms of systems such as German law had to be considered. The arguments against the notion that it is necessary to attribute a retrospective effect to a declaration of set-off in order to protect the debtor's reasonable belief that his debt has been extinguished by set-off have been discussed above.²⁹¹ It was further found to be illogical to separate the date of “conception” of set-off (i.e. the day a declaration to that effect is made) from the date it takes effect.²⁹² If set-off operates automatically, and a declaration is therefore not required, a natural

²⁸³ Zimmermann *European Law of Set-Off* 36.

²⁸⁴ Pichonnaz “*Compensatio*” in *Principles of European Contract Law* 287.

²⁸⁵ Jauffret-Spinosi “UNIDROIT 2000 Study L – Doc 62 bis: Position Paper” *UNIDROIT* 6.

²⁸⁶ 6.

²⁸⁷ Pichonnaz & Gullifer *Set-Off in Arbitration* 170

²⁸⁸ Pichonnaz “*Compensatio*” in *Principles of European Contract Law* 286.

²⁸⁹ 288.

²⁹⁰ Pichonnaz & Gullifer *Set-Off in Arbitration* 172.

²⁹¹ See 3 6 above.

²⁹² Jauffret-Spinosi “UNIDROIT 2000 Study L – Doc 62 bis: Position Paper” *UNIDROIT* 7-8.

consequence would be that set-off is given effect from the date it first became possible. However, where a declaration is required before set-off can occur, the more logical construction would be that set-off becomes effective from the date of such a declaration. The date of declaration of the set-off is also easier to establish than the date on which set-off first became possible.²⁹³

At first glance, the notion of effecting set-off by way of a declaration with prospective effect seems foreign to legal systems which base their approach to set-off on Roman law, as it is contrary to the approaches which developed subsequent to Justinian's decrees. However, it has been shown in the previous chapter that this is not necessarily the case. These opinions developed in response to the use by Justinian of the phrase "*ipso iure*", but read in context the decrees relied on in support of an automatic extinction of debt by set-off were not necessarily intended to introduce such a system.²⁹⁴ The possibility that requiring a declaration without a retrospective effect corresponds with the approach envisioned by the *Corpus Iuris Civilis* and that deviating views developed due to misconceptions, can therefore not be discarded.

There are at least three reasons which justify attributing an *ex nunc* effect to the notice of set-off.²⁹⁵ First, requiring an extra-judicial notice to effect set-off enables the debtor to decide when he wants to discharge his obligations.²⁹⁶ Performance also operates in this manner, and it is preferable that set-off should, despite the differences between the two, have the same effects as performance.²⁹⁷

This justification also informs the second reason for the *ex nunc* effect of the notice. If set-off operates *ipso iure* or with retrospective effect, it provides security where the other party becomes insolvent, as the creditor of the insolvent will still be able to "recover" his debt to the extent that set-off is possible. However, the PICC and the PECL emphasise the performance function of set-off:²⁹⁸ by requiring a notice with an

²⁹³ 7.

²⁹⁴ See ch 2 (2 4 4).

²⁹⁵ Pichonnaz "Set-Off" in *UNIDROIT Principles* 1073; Pichonnaz "*Compensatio*" in *Principles of European Contract Law* 295.

²⁹⁶ Pichonnaz "Set-Off" in *UNIDROIT Principles* 1073; Pichonnaz "*Compensatio*" in *Principles of European Contract Law* 295.

²⁹⁷ Pichonnaz "Set-Off" in *UNIDROIT Principles* 1073; Pichonnaz "*Compensatio*" in *Principles of European Contract Law* 295.

²⁹⁸ See ch 1 (1 2 2) for a discussion of this function of set-off.

ex nunc effect, the performance function is strengthened, while dispensing with the notion that set-off must fulfil this security function.²⁹⁹ Insolvency laws can however still provide for automatic set-off upon insolvency and thereby restore the security function of set-off.

Thirdly, interest will continue to accrue until set-off is declared. This will induce parties (or at least the party paying the higher interest rate)³⁰⁰ to set their debts off as soon as possible, which will enhance certainty. There is also no reason to give a debtor the benefit of preventing the accrual of interest where he is free to declare set-off at any time.³⁰¹ Similarly, there is no reason to protect a debtor from the consequences of breach, where the debtor was able to declare set-off, but failed to do so. The subsequent declaration does not condone the debtor's earlier breach, and there is no justification for curing the breach retrospectively.³⁰²

The consequence of the prospective approach is that at the date the declaration is given, the debts are discharged, provided all the requirements for set-off are met. Therefore interest will accrue until notice of set-off is given.³⁰³ If breach occurred before the declaration, such a breach will not be cured by the declaration, similar to where payment is made after the due date.³⁰⁴ Any payments made after the date set-off is declared will constitute an undue amount and can be reclaimed under the laws of unjustified enrichment.³⁰⁵ Payments made before that date will merely serve to discharge the indebtedness and set-off will not be able to operate in respect of the extinguished portion of the debt, since there is no longer a mutuality of claims.³⁰⁶

3 8 Suggestions for reform in South Africa

When analysing the South African approach to set-off, the impression is gained that judges select the consequences of whichever approach they prefer to apply or regard

²⁹⁹ Pichonnaz "Set-Off" in *UNIDROIT Principles* 1073; Pichonnaz "*Compensatio*" in *Principles of European Contract Law* 296. See ch 1 (1 2 2 n 45) for the criticism levelled against the security function of set-off.

³⁰⁰ Official Comment 2 to Art 8.5; Lando et al *European Contract Law* 151.

³⁰¹ Pichonnaz "*Compensatio*" in *Principles of European Contract Law* 296.

³⁰² Lando et al *European Contract Law* 152.

³⁰³ Lando et al *European Contract Law* 151; Pichonnaz "*Compensatio*" in *Principles of European Contract Law* 296; Pichonnaz & Gullifer *Set-Off in Arbitration* 184.

³⁰⁴ Pichonnaz & Gullifer *Set-Off in Arbitration* 184-185.

³⁰⁵ Lando et al *European Contract Law* 152; Pichonnaz "*Compensatio*" in *Principles of European Contract Law* 296.

³⁰⁶ Lando et al *European Contract Law* 152.

as the most appropriate in a given situation. For instance, those judges who recognise that set-off operates *ipso iure*, are somehow still of the opinion that the defendant can choose to pay his debt rather than to invoke set-off. The rules relating to multiple debtors or creditors are also wholly inconsistent with the *ipso iure* approach.

Even if these inconsistencies are overlooked, the biggest shortcoming of the current system is the inability of either of the approaches to set-off to regulate modern business and banking relationships in a manner which corresponds with normal commercial practices. For instance, we have seen that the effect set-off has both on the charging of interest and a party's default is so problematic in practice that banks are compelled to regulate the operation of set-off contractually. Jurisdictions which share our historical foundation of set-off do not offer solutions, as the same problems are experienced there.

The reasoning which influenced the drafters of both the PICC and the PECL to require a notice in order to effect set-off and to discard the notion of retrospective operation may be instructive when considering the South African position. There can be no denying that requiring a notice which operates *ex nunc* "constitutes the commercially most efficient and equitable solution"³⁰⁷ and that:

"to deny a retroactive effect to the declaration of set-off has the advantage of creating a legal situation which is simple and clear, and which is harmonious with the fact that the claims remain unaffected until the declaration of set-off."³⁰⁸

If set-off operates *ex nunc* upon it being declared by one party, the consequences will be similar to payment being made at that moment.³⁰⁹ Therefore, interest will run until set-off is declared, and will cease the moment the debtor gives notice of set-off. Payments made after notice has been given of set-off constitutes undue payments, but payments made before that time will merely be performance, as there is no possibility of set-off discharging the obligation prior to that time. These consequences are logical and lead to a more natural and "entirely satisfactory result".³¹⁰

³⁰⁷ Pichonnaz "Set-Off" in *UNIDROIT Principles* 1073.

³⁰⁸ Pichonnaz 2000 *TR* 562.

³⁰⁹ For a discussion of the consequences, see Pichonnaz "Compensatio" in *Principles of European Contract Law* 297; Pichonnaz & Gullifer *Set-Off in Arbitration* 184-185; Zimmermann *European Law of Set-Off* 41-43.

³¹⁰ Lando et al *European Contract Law* 154 n 2.

Attributing a prospective effect to a declaration of set-off will mean that set-off will not be possible where one of the requirements has ceased to exist before set-off has been declared. This consequence of attributing an *ex nunc* effect to set-off will be especially relevant where the debt has been ceded or if one of the parties becomes insolvent before notice of set-off is given. These two situations must therefore be considered in more detail.

It can be argued that a person should not be allowed to use cession as a means to escape the operation of set-off.³¹¹ The possibility of cession being utilised by a cedent to avoid set-off is much greater where set-off does not operate automatically or if a declaration of set-off does not have a retrospective effect. This is because attributing a prospective effect to a declaration of set-off would preclude a debtor from relying on set-off if he failed to declare it before the cession occurred. If set-off operates *ipso iure* or retrospectively, the debtor is able to rely on set-off in respect of a debt owed by the cedent even if the debt is subsequently ceded, provided the requirements for set-off were met before the cession.

For example, A and B are mutually indebted and B cedes his debt to C after the requirements for set-off were fulfilled, but before A declared set-off. In terms of the two approaches to set-off currently followed in South African law, A will either be able to rely on the fact that set-off occurred automatically before the cession or his declaration will operate retrospectively to before the debt was ceded. Therefore, once the debts are susceptible to set-off, B cannot escape the operation of set-off by ceding the debt. However, if the declaration does not have a retrospective effect, it will mean that A can no longer rely on set-off against the cedent and B is therefore allowed to avoid the operation of cession.

This difference in practical outcome where a declaration is made after cession was effected, which will be the result of denying the retroactive operation of set-off, can be regulated within the law of cession. Some protection is already granted to the debtor where he performs in good faith before receiving notice of the cession or where the cession is *mala fide*.³¹² Thus, if A in the example above declares set-off before he

³¹¹ Van Niekerk 1968 SALJ 44-46, with reference to Voet 5 1 84 and Jan van Sande *De actionum cession* 10 2.

³¹² See the exceptions mentioned in 3 4 2 2 above.

becomes aware of the cession, or if B ceded the debt for the purpose of evading the operation of set-off, A will still be entitled to rely on set-off even if the prospective approach is adhered to. This protection can perhaps be extended, based on the common law rule that a creditor cannot render the position of his debtor more burdensome through cession.³¹³ But arguably, the existing provisions provide sufficient protection, as it is difficult to imagine a situation where a debtor should be allowed to rely on set-off against a cedent in spite of the fact that the debtor was aware of the cession (or did not perform in good faith), and the cedent was not mala fide.

Requiring a declaration with *ex nunc* effect would also have an important effect on the so-called security function of set-off in the case of insolvency. The proposed system of set-off would only provide protection to a creditor of an insolvent who has declared set-off before *concursum creditorum*. However, in South Africa set-off upon insolvency is already partially regulated by statute,³¹⁴ and most legal systems have specific rules that deal with set-off in the context of insolvency.³¹⁵ The suggestion would therefore be that if policy considerations require that a creditor of an insolvent who is able to declare set-off upon insolvency must receive protection, it should be provided for by insolvency law. One suggestion of how this can be effected is by stating that set-off is deemed to be declared upon insolvency. Although this may be contrary to the notion that set-off should be the result of an exercise of will, it may be justified if policy considerations in the law of insolvency require that a creditor of an insolvent who has a claim against the insolvent estate should be awarded his full claim, rather than merely a dividend. This security function of set-off was possibly already recognised in classical Roman law, where the estate of an insolvent was purchased by the *bonorum emptor* and he was then only allowed to claim from debtors the balance of claims owed to the estate.³¹⁶ Nonetheless, it must be decided whether there is justification for this type of protection in modern insolvency law.

It is desirable that the approach to set-off which is selected should be applied as consistently as possible with the theoretical principles underlying it. Both the current approaches followed in South Africa have failed to achieve this ideal. A system where

³¹³ Van Niekerk 1968 SALJ 45-46, with reference to Voet 18 4 13.

³¹⁴ See 3 4 2 3 above.

³¹⁵ Lando et al *European Contract Law* 143 n7; Zimmermann "Set-Off" in *The Max Planck Encyclopedia* 1557.

³¹⁶ See ch 2 (2 2 2 2).

set-off operates *ex nunc* upon notice offers a much more coherent approach. The possible problems which arise from abolishing the *ipso iure* or retrospective effect of set-off would occur in situations where it overlaps with other areas of the law and where it is to a certain extent already regulated by the rules applicable in those contexts. Where policy considerations therefore require a deviation from the rules surrounding set-off in the context of cession or insolvency, they can be easily be provided for by the rules applicable in those areas.

Legal reality should resemble practical reality as closely as possible. It is not clear why a legal situation should be sustained if it is based on questionable historical foundations and, more importantly, is so out of touch with commercial reality that the business and banking community it is supposed to serve is forced to regulate the situation contractually. In the absence of a proper historical foundation or other policy considerations, legal certainty should not be sacrificed to maintain a *status quo* which is clearly unsatisfactory.

CHAPTER 4: EXCLUSION OF THE RIGHT TO RELY ON SET-OFF: AGREEMENT, WAIVER AND ESTOPPEL

4 1 Introduction

The previous chapter analysed the two approaches to the operation of set-off followed in South African law, namely that it either operates *ipso iure* the moment the requirements for its operation are met, or retrospectively upon it being declared by either party. Despite the conclusion that neither approach produces an optimal outcome, these approaches still reflect the prevailing legal situation. Therefore, in the absence of legal development in this regard by the courts or the legislature, the principles surrounding the current approaches are still relevant.

It will now be examined when a party will be precluded from relying on set-off, and to what extent the parties can vary the requirements¹ for, or the operation of, set-off. This chapter will attempt to clarify the following: (i) the applicable principles where the parties have agreed not to rely on set-off or have varied the way in which it will operate in their specific situation; (ii) the acts or omissions which will constitute a waiver of a party's right to invoke set-off; and (iii) the circumstances in which a party can be estopped from invoking his right to set-off.

Unavoidably, the view that is followed with regards to the operation of set-off also has an impact on the theoretical (if not practical) application of these principles. This aspect will therefore also be analysed.

4 2 Agreement to exclude or vary the operation of set-off

4 2 1 Introduction

The first question which will be considered is whether parties can agree to exclude the operation of set-off. In this regard, it is important to distinguish between two different scenarios, namely whether the parties agreed to exclude the operation of set-off before the debts were susceptible to set-off, or whether they reached agreement after the requirements for set-off were met.

¹ See ch 3 (3 2) for a discussion of the requirements for set-off.

This section will also examine the extent to which the parties may vary the operation of set-off by either removing or adding certain requirements for its operation. As shown in the previous chapter, the practical difficulties resulting from both accepted views regarding the operation of set-off compels credit providers, especially banks, to regulate the operation of set-off contractually.² It is therefore important to determine to what extent parties will be allowed to do so.

4 2 2 Agreement to exclude the operation of set-off

4 2 2 1 Agreement concluded before set-off could operate

It is generally accepted that the parties can, by prior agreement, exclude the operation of set-off.³ This does not have to be an express agreement;⁴ the operation of set-off can also be excluded by way of a tacit agreement⁵ or a tacit term in the agreement⁶ between the parties.

² See ch 3 (3 4 2 4, 3 4 2 5 and 3 4 2 6).

³ *Blakes Mphanga Inc v Outsurance Insurance Co Ltd* 2010 4 SA (SCA); *Herrigel NO v Bon Roads Construction Co (Pty) Ltd* 1980 4 SA 669 (SWA); *Altech Data (Pty) Ltd v M B Technologies (Pty) Ltd* 1998 3 SA 748 (W); LTC Harms "Obligations" in WA Joubert (ed) *The Law of South Africa* 19 2 ed (2006) para 245; BvD van Niekerk "Some Thoughts on the Problem of Set-Off" (1968) 85 SALJ 31 34.

⁴ See *Herrigel NO v Bon Roads Construction Co (Pty) Ltd* 1980 4 SA 669 (SWA) 676, where it was held that an agreement to exclude the operation of set-off can be inferred from the manner in which the parties conduct their business.

⁵ There are two tests which the courts apply to infer a tacit agreement (see *Standard Bank of South Africa Ltd v Ocean Commodities Inc* 1983 1 SA 276 (A) 292A-B, where it was said that it is necessary to show "by a preponderance of probabilities, unequivocal conduct which is capable of no other reasonable interpretation than that the parties intended to, and did in fact, contract on the terms alleged"; and *Joel Melamed and Hurwitz v Cleveland Estate (Pty) Ltd; Joel Melamed and Hurwitz v Vorner Investments (Pty) Ltd* 1984 3 SA 155 (A) 165B, where it was said that "a court may hold that a tacit contract has been established where, by a process of inference, it concludes that the most plausible probable conclusion from all the relevant proved facts and circumstances is that a contract came into existence"). For an attempt at reconciliation of these two tests, see RH Christie & GB Bradfield *Christie's The Law of Contract in South Africa* 6 ed (2011) 84-93. However, a discussion of this debate falls outside of the scope of this thesis.

⁶ The court normally employs the official bystander test to infer a tacit term (in terms whereof the court will acknowledge a tacit term if it is satisfied that the parties, being asked at the time the contract was negotiated what will happen in a certain case, would have replied "of course so and so will happen"), and further requires that the term must be objectively necessary to give business efficiency to the agreement. In this regard, see MFB Reinecke, JP van Niekerk & PM Nienaber "Insurance" in WA Joubert & JA Faris (eds) *The Law of South Africa* 12(1) 2 ed (2012) para 245, with reference to *Reigate v Union Manufacturing Co (Ramsbottom)* 1919 1 KB 592; C Maxwell "Obligations and Terms" in in D Hutchison & C-J Pretorius (eds) *The Law of Contract in South Africa* 2 ed (2012) 233 247; *Consol Ltd t/a Consol Glass v Twee Jongegezellen* 2005 6 SA 1 (SCA) para 50-51; *Alfred McAlpine & Son (Pty) Ltd v Transvaal Provincial Administration* 1974 3 SA 506 (A) 533; *Seven Eleven Corporation of SA (Pty) Ltd v Cancun Trading No 150 CC* 2005 5 SA 186 (SCA) para 34; *Alfred McAlpine & Son (Pty) Ltd v Transvaal Provincial Administration* 1974 3 SA 506 (A) 533; Joel

Van der Merwe and others state that:

“[t]he possibility that parties may by agreement exclude the operation of set-off in respect of debts that may arise between them is a further indication that the theoretical and practical significance of the two supposedly opposing views [to the operation of set-off] should not be overemphasised.”⁷

They do not elaborate on the meaning of this statement, but presumably it refers to the fact that by allowing the parties to exclude the operation of set-off, they can prevent set-off from operating even if it is held to operate automatically. Thus, set-off will be subject to the wishes of the parties even in terms of the *ipso iure* approach. However, they fail to consider how the fact that the parties may agree to exclude the operation of set-off can be reconciled with the two opposing views of the operation of set-off, and in fact it is something that is rarely considered.

If the view is followed that set-off depends on a declaration by one party, the situation is uncomplicated. In terms of that approach, the operation of set-off is clearly linked to the will of the parties⁸ – if neither of the parties wishes to declare set-off (i.e. in the absence of a declaration), it will not operate. The autonomy of the parties is clearly recognised and they are allowed to elect whether set-off operates or not.⁹ There is thus no difficulty with the parties agreeing to exclude the operation of set-off between them – in effect, they are each undertaking to each other that neither may declare set-off, and therefore set-off cannot be effected.

On the other hand, the view that set-off operates automatically is inevitably linked to the notion that it operates irrespective of the wishes of the parties.¹⁰ If set-off operates automatically, the question whether the parties should be allowed to exclude the operation of set-off by agreement depends on the whether or not “legal policy

Melamed and Hurwitz v Cleveland Estate (Pty) Ltd; Joel Melamed and Hurwitz v Vornier Investments (Pty) Ltd 1984 3 SA 155 (A) 165D. A discussion of this test falls outside the scope of this thesis.

⁷ S van der Merwe, LF van Huyssteen, MFB Reinecke & GF Lubbe *Contract – General Principles* 4 ed (2012) 474.

⁸ JC de Wet & AH van Wyk *Die Suid-Afrikaanse Kontraktereg en Handelsreg* 1 5 ed (1992) 282.

⁹ S Scott “Skuldvergyking – Toe (ex tunc) en Nou (ex nunc)” 2006 *TSAR* 595 597; Van der Merwe et al *Contract* 474.

¹⁰ See for instance *Van Aswegen v Pienaar* 1967 3 SA 677 (O) 681D-E, where it is said that the difference between payment and set-off is that the former bears a close connection to the will of the payee, whereas the latter takes place *ipso iure*; De Wet & Van Wyk *Kontraktereg* 1 282; Van der Merwe et al *Contract* 470 n 230, where they admit that there is an inclination towards the view that set-off operates irrespective of the parties’ wills. See further the discussion in ch 3 (3 4 1).

outweighs the principle of individual autonomy sufficiently to permit the operation of set-off irrespective of the will of either of the parties involved.”¹¹

The law generally favours the autonomy of parties and all civil law jurisdictions (including those which attribute an *ipso iure* operation to set-off) accept that the parties can exclude the operation of set-off contractually.¹² This follows from the principle of freedom of contract. Based on the same principle, the PECL recognises that set-off cannot be effected if it is excluded by agreement,¹³ and exclusion of set-off by agreement will also be possible under the PICC.¹⁴ South African law also recognises the autonomy of parties, and therefore, if two parties agree

“expressly, or at least by necessary implication, in their dealing with each other ... not to set off their reciprocal debts but to pay them to each other in full ... it does not [lie] in the mouth of [a party] to contend that set-off operates automatically in respect of their mutual indebtedness, nor can [the party] now insist upon or claim set-off when it specifically chose not to do so at the time that set-off would have operated had it at that time chosen to rely thereon.”¹⁵

The ostensible conflict between allowing parties to contract out of the operation of set-off and the fundamental principle of the *ipso iure* approach to the operation of set-off, namely that set-off operates irrespective of the will of the parties,¹⁶ has not been resolved. Two possible solutions can be offered to address this inconsistency.

The first potential solution can be found in Joubert’s construction of the requirements of set-off. He states that set-off must not be contractually excluded as a fifth requirement for set-off to take place.¹⁷ Although is generally not recognised as a requirement for set-off and recognising it as such does not make a practical difference, Joubert’s construction has a theoretical advantage. If set-off is excluded, one of the

¹¹ Van der Merwe et al *Contract* 470.

¹² R Zimmermann *Comparative Foundations of the European Law of Set-Off and Prescription* (2002) 57; P Pichonnaz & L Gullifer *Set-Off in Arbitration and Commercial Transactions* (2014) 16, 168; O Lando, H Beale, A Prüm & R Zimmermann (eds) *The Principles of European Contract Law: Part III* (2003) 155 n 1.

¹³ Art 13:107(a).

¹⁴ P Pichonnaz “Set-Off” in S Vogenauer (ed) *Commentary on the UNIDROIT Principles of International Commercial Contracts (PICC)* 2 ed (2005) 1033 1039.

¹⁵ *Herrigel NO v Bon Roads Construction Co (Pty) Ltd* 1980 4 SA 669 (SWA) 676-677.

¹⁶ See n 10 above.

¹⁷ DJ Joubert *General Principles of the Law of Contract* (1987) 292.

requirements for its operation is not met and therefore (despite its automatic operation) set-off cannot operate between the two parties.

Another possible solution is to treat the right to set-off as an implied term in the contract between parties,¹⁸ and therefore imposed by “a rule of law which the Court will apply unless validly excluded by the contract itself”¹⁹ and which “can be varied or made inapplicable by agreement.”²⁰ Set-off operates by virtue of a common law rule,²¹ and is incorporated in the legal relationship of the parties without depending on their intention. Although the right to invoke set-off is never explicitly recognised as an implied term, it can be argued that this is effectively what is done by allowing parties to contract “out of the otherwise automatic applicability of set-off”.²² In this manner, set-off does not lose its character as a manner in which agreements are terminated by operation of law, but operates by way of an implied term in the agreement between the parties.

Regardless of the theoretical explanation underlying the parties’ right to exclude set-off by means of agreement, our law clearly accepts that contracting parties are free to preclude it from operating between them.²³ However, even where an agreement to exclude set-off is concluded before set-off could operate, it does not necessarily mean that the agreement must be concluded before the debts arose. The parties could for instance conclude such an agreement while one of the debts is not yet due and payable or not sufficiently liquid.

Where the parties agree not to invoke set-off in respect of a debt which is secured by a suretyship (and before set-off could operate in respect of that debt), such an agreement could prejudice a surety. The exclusion of set-off would prevent the surety from being released by way of set-off between the debtor and the creditor. Therefore,

¹⁸ On the definition of an implied term, see *Alfred McAlpine & Son (Pty) Ltd v Transvaal Provincial Administration* 1974 3 SA 506 (A) 526.

¹⁹ *Alfred McAlpine & Son (Pty) Ltd v Transvaal Provincial Administration* 1974 3 SA 506 (A) 532G.

²⁰ *Bredenkamp v Standard Bank of South Africa Ltd* 2010 4 SA 468 (SCA) para 6.

²¹ *Schierhout v Union Government (Minister of Justice)* 1926 AD 286 289; Joubert *Law of Contract* 286.

²² *Herrigel NO v Bon Roads Construction Co (Pty) Ltd* 1980 4 SA 669 (SWA) 677.

²³ *Herrigel NO v Bon Roads Construction Co (Pty) Ltd* 1980 4 SA 669 (SWA) 677; *Blakes Mphanga Inc v Outsurance Insurance Co Ltd* 2010 4 SA (SCA) para 15: “Although set-off operates *ipso iure* its operation may be excluded by agreement”. It must be noted that an agreement to exclude the operation of set-off will not prevent a defendant from raising a claim in reconvention (*Consol Ltd t/a Consol Glass v Twee Jongegezellen* 2002 2 SA 580 (C); *Van der Merwe et al Contract* 473).

if such an agreement is concluded after the debt is secured, Van Niekerk argues that the surety must consent to such an agreement.²⁴ He is of the view that, in the absence of such consent, the surety will not be bound to the agreement and will thus be able to raise set-off as a defence despite the debtor and creditor being barred from doing so. Effectively, the surety will therefore be released to the extent that set-off could have taken place in the absence of the agreement.²⁵ This is in line with the general principle that the accessory obligation of a surety may be extinguished

“wholly or in part, if the creditor in his or her dealings with the principal debtor and other sureties acts in such a way as to prejudice the surety or increase his or her burden. Thus, if the creditor, without the surety’s consent, agrees with the principal debtor upon a material alteration or variation of the principal obligation which will prejudice the surety, the latter is released.”²⁶

However, the Supreme Court of Appeal recently expressed the opinion that where a creditor is entitled to rely upon set-off, but not obliged to do so, the failure to apply set-off will not amount to a breach of the terms of a suretyship.²⁷ It was further stated that a surety will only be released “if the prejudice is the result of a breach of some other legal duty or obligation.”²⁸ Although this judgement seems to nullify the argument made previously with regards to the release of a surety where set-off can operate, the court’s reasoning was based on a term of the principal agreement (of which the sureties were aware)²⁹ which entitled the creditor, in its sole discretion, to rely on set-off.³⁰ It can thus be argued that the case can be distinguished from Van Niekerk’s reasoning, and it is not clear whether a similar conclusion will be reached where the right to set-off does not flow from an agreement, but is based on the common law.

4 2 2 2 *Agreement concluded after set-off could operate*

Whether the parties can reach an agreement not to invoke set-off after the requirements for set-off were satisfied is more contentious, especially where the *ipso*

²⁴ 1968 SALJ 37.

²⁵ 37.

²⁶ JJ Henning & KL Mould “Suretyship” in WA Joubert & JA Faris (eds) *The Law of South Africa* 26 2 ed (2015) para 307.

²⁷ *Dominick v Nedbank Limited* (20463/14) 2015 ZASCA 160 (13 November 2015) para 18.

²⁸ Para 15, with reference to *ABSA Bank Ltd v Davidson* 2000 1 SA 1117 (SCA) para 19.

²⁹ Para 5.

³⁰ Para 19.

iure operation of set-off is accepted.³¹ This problem will rarely, if ever, arise if a declaration is required for set-off to operate. Because the requirements for set-off in terms of that construction are only satisfied once the declaration is made, any agreement to exclude the operation of set-off concluded before either party has declared set-off will fall in the category mentioned above, i.e. an agreement concluded before set-off could operate.³² In other words, set-off cannot operate before a declaration is made, therefore it is only where the parties agree to exclude the operation of set-off after one of them has already declared set-off that the problematic situation discussed below will arise. It is improbable that the parties would reach such an agreement where one of them already gave notice of set-off to the other.

In terms of the *ipso iure* construction, set-off is held to extinguish the debts automatically as soon as the requirements for set-off are met, without requiring a declaration by either party. Technically the debts no longer exist after set-off could operate. Therefore, after the debts became susceptible to set-off, it should be impossible to exclude the operation of set-off – it is no use closing the stable door after the horse has bolted. Nonetheless, the possibility has been mooted that some scope still exists for parties to exclude the operation of set-off after the debts were extinguished due to the automatic operation of set-off.

One possibility is that the subsequent agreement is regarded as a kind of novation: the extinguished or partially extinguished obligations are substituted with new obligations identical to those which would have existed if set-off did not take place.³³ However, there are two problems with accepting that the parties novated their obligations by agreeing to exclude the operation of set-off.

First, for novation to occur it must be proved that the parties intended to substitute the old obligation for the new one.³⁴ It is doubtful whether either of the parties had the intention of replacing their obligations with a new obligation when all they meant to do was to exclude the operation of set-off. Inferring an intention to novate where the

³¹ Van Niekerk 1968 *SALJ* 37.

³² See 4.2.2.1 above.

³³ Van Niekerk 1968 *SALJ* 37.

³⁴ Harms "Obligations" in *LAWSA* 19 para 239.

parties' only aim was to ensure that the debts would not be susceptible to set-off misconstrues the concept of novation.

A second problem with accepting novation of the debts is that an intended novation can only be effective if the obligation meant to be novated is still in existence.³⁵ As mentioned above, where set-off operates *ipso iure*, the debts would have been extinguished the moment that the requirements for set-off were met and there is therefore no obligation left to novate.

An alternative solution would be to infer a new agreement between the parties in terms of which they incur new debts, on the exact same terms and conditions as the old debts, except for the condition that set-off would not operate. This might avoid the second problem identified with regards to accepting a novation of the debts, but offers no solution to the first problem. Again, it is quite a stretch to imagine that the parties had the intention to conclude an entirely new agreement where they only expressed (or by their conduct indicated) the desire for set-off not to operate – and where one of the parties claims amounts outstanding, he will undoubtedly base his claim on the original agreement.

A further question which arises is whether such a novation or new agreement will be allowed where it affects the rights of third parties, for instance a surety?³⁶ Similar to the situation where set-off is excluded after the debts were secured,³⁷ a surety who does not consent to the agreement to exclude the operation of set-off cannot be bound to it. He will therefore be released *pro tanto* to the extent that set-off could have operated between the debtor and creditor, subject to the terms of the suretyship agreement.³⁸

From the above it can be seen that reconciling the fact that parties are allowed to exclude the operation of set-off by agreement with the minority view of set-off is not problematic. However, if it is accepted that set-off operates *ipso iure*, the situation becomes a lot more complicated, especially where the agreement to exclude set-off is

³⁵ Para 239.

³⁶ Van Niekerk 1968 SALJ 37.

³⁷ See 4 2 2 1 above.

³⁸ Van Niekerk 1968 SALJ 37. However, also see *Dominick v Nedbank Limited* (20463/14) 2015 ZASCA 160 (13 November 2015), as well as the discussion in 4 2 2 1 above.

concluded after the debts were susceptible to set-off. These problems are aggravated where the debts are secured by way of surety.

4 2 3 Agreement to vary requirements or operation of set-off

Instead of entirely excluding set-off, the parties may prefer to contractually vary either the requirements for set-off to operate (such as prescribing a notice) or the timing thereof, for instance by excluding the automatic operation of set-off without preventing either of the parties from relying on set-off. This would ensure certainty with regards to the operation of set-off in practice. Arguably, if it is possible for parties to exclude set-off by agreement, it should also be possible for parties to stipulate the way it operates in their specific circumstances.

South African literature on the ability of parties to vary the operation of set-off contractually is scarce. However, internationally this is an important commercial concept known as “contractual set-off” or “set-off by agreement”.³⁹ Set-off by agreement is accepted by most legal systems based on the recognition of the autonomy of contracting parties,⁴⁰ although in most instances the freedom of the parties to provide for contractual set-off are subject to certain statutory limitations, for instance those imposed by insolvency laws.⁴¹ It is further recognised in terms of the both the PICC⁴² and the PECL⁴³ that the parties may effect set-off by agreement even if the prescribed requirements are not met.

There are numerous examples of the possible variations which the parties can provide for. For instance, the parties could agree that set-off will operate before the debts are due and payable. This offers a bank an opportunity to set off amounts owed to the client against a loan made to the client, but in respect of which the date of payment has not yet arrived.⁴⁴ Parties can also agree to relax the mutuality requirement, which

³⁹ Pichonnaz & Gullifer *Set-Off in Arbitration* 14.

⁴⁰ Pichonnaz & Gullifer *Set-Off in Arbitration* 15; Lando et al *European Contract Law* 149 n 2. Also see C Fountoulakis *Set-Off Defences in International Commercial Arbitration: A Comparative Analysis* (2011) 56, 97-98. For the importance of contractual set-off in English law, see PR Wood *English and International Set-Off* (1989) 147-232.

⁴¹ Pichonnaz & Gullifer *Set-Off in Arbitration* 15.

⁴² Official Comment 8 to Art 8.1.

⁴³ Lando et al *European Contract Law* 148-149.

⁴⁴ Wood *Set-Off* 162-163.

can enable a bank to set off a loan owed by one company in a group of companies against money deposited on behalf of another company in that group⁴⁵ (subject to the provisions of the Companies Act 71 of 2008).⁴⁶

Although the parties are able to vary the manner in which set-off will operate by agreement, it does not mean that the party invoking set-off is entitled to stipulate unilaterally how set-off should take place. Even if the party declaring set-off should wish for set-off to take effect only on the date it is declared or pleaded by him, he cannot (for instance by stipulating this in his declaration) avoid the fact that set-off operates when the requirements for it are first satisfied.⁴⁷ In other words, the operation of set-off can only be varied by prior agreement between the parties.

4 3 Waiver of right to rely on set-off

4 3 1 Introduction

The next issue for consideration is whether a party can waive his right to rely on set-off. This was answered in *Southern Cape Liquors (Pty) Ltd v Delipcus Beleggings BK*,⁴⁸ where the Cape Division confirmed Van Leeuwen's opinion⁴⁹ that

"n skuldenaar afstand kan doen van sy reg om op skuldvergelyking staat te maak ... [waar] dit op 'n oorwig van waarskynlikhede bewys word dat die skuldenaar, met volle kennis van sy reg, besluit het om daarvan afstand te doen, hetsy uitdruklik hetsy deur gedrag wat onversoenbaar is met die bedoeling om die reg te behou en uit te oefen."⁵⁰

Accepting that a party may waive his right to invoke set-off is not problematic in terms of the minority view of set-off. In terms of that view, a declaration by one of the parties is required to effect set-off. A party is entitled to waive his right to make such a declaration and, in the absence of a declaration by either party, set-off cannot be effected.

⁴⁵ 169.

⁴⁶ See s 45, which sets certain requirements for lending money or securing a debt of a related or inter-related company.

⁴⁷ *South African Metropolitan Life Assurance Co Ltd v Ferreira* 1962 4 SA 213 (O) 215.

⁴⁸ 1998 4 SA 494 (C).

⁴⁹ Van Leeuwen *Cens For* 1 4 36 1.

⁵⁰ 500: "A debtor can waive his right to rely on set-off where it is proven on a balance of probabilities that the debtor, with full knowledge of his right, decided to waive it, whether expressly or through conduct which is irreconcilable with the intention to retain and exercise the right" (own translation).

However, the notion of waiver of a party's right to rely on set-off becomes more problematic if the view is adopted (as in the majority of cases) that set-off operates *ipso iure* on the date that the debts become susceptible to set-off. The questions that arise are similar to those where the parties contract out of the operation of set-off,⁵¹ namely: (i) if set-off operates irrespective of the will of the parties, and therefore discharges the debts even where neither party desires it,⁵² what right exists to be waived by a party prior to set-off occurring; and (ii) even if it is accepted that a party can waive his right to rely on set-off, how can that be done after the debts were already extinguished automatically at the moment that set-off could operate?

The first question was partially discussed above,⁵³ when the exclusion of set-off by way of agreement was considered. Presumably, the reason for allowing a party to waive his right to rely on set-off is also based on the autonomy of contracting parties. However, the concept of waiver is even more problematic, as it presupposes that the party effecting the waiver possesses a right. In *Hardy NO v Harsant*,⁵⁴ Mason J recognised the inconsistency between holding that set-off operates *ipso iure* or automatically, and yet treating it as a right which a party can decide whether to assert.⁵⁵ However, this did not deter the Appellate Division in *Schierhout v Union Government (Minister of Justice)*⁵⁶ from regarding set-off as a right which a party may elect to exercise,⁵⁷ despite an apparent recognition of the automatic nature of set-off.⁵⁸ In that case, the appellant was a former employee of the Government and was receiving monthly pension payments from it. The Government also obtained a taxed cost order against the appellant.⁵⁹ Instead of relying on set-off to discontinue the payment of monthly pension instalments until the cost order was settled, the Government opted to reduce every subsequent pension payment to the appellant by a certain amount.⁶⁰ However, when the appellant obtained a claim against the Government for arrear

⁵¹ See 4 2 above.

⁵² See n 10 above.

⁵³ See 4 2 2 1 above.

⁵⁴ 1913 TDP 433.

⁵⁵ 447-448.

⁵⁶ 1926 AD 286.

⁵⁷ 293.

⁵⁸ 289-290.

⁵⁹ 289.

⁶⁰ 293.

salary payments,⁶¹ the amount of which was slightly less than the outstanding balance of the cost order,⁶² the Government set this claim off against the cost order.⁶³ The appellant averred that failure by the Government to invoke set-off in respect of the full amount of the monthly pension payments amounted to waiver of this right in respect of the cost order, but the court found that partially exercising the right to set-off from time to time (by reducing every pension payment) is not inconsistent with the intention to retain the right to invoke set-off in future.⁶⁴ Recognising set-off as a right which a party can choose to invoke is clearly problematic if the automatic approach to set-off is followed, since it undermines the foundation of the *ipso iure* approach, namely that the debts are extinguished by operation of law without requiring any action by the parties.

Even if it is accepted that set-off “is a right which parties must claim if they desire to have the benefit of it”⁶⁵ (a construction very similar to the notion that set-off must be declared), it does not alter the core principle of the *ipso iure* view that the debts are extinguished automatically at the moment set-off becomes possible.⁶⁶ Subsequent waiver of the right to rely on set-off cannot change the fact that the debt is no longer in existence, and allowing such a waiver will mean that the debt is revived. This is analogous to the scenario where the parties contract out of the operation of set-off after the debt became susceptible to set-off⁶⁷ and can only be explained by way of a novation of the debt or a new agreement between the parties. However, this will mean that the party relying on the waiver has to prove that both parties had the prior intention to novate the agreement or to conclude a new agreement, before the right to rely on set-off was waived.

Despite the theoretical uncertainty, it is accepted that the right to invoke set-off may be waived by either party both before and after the requirements for set-off were met,⁶⁸ although waiver by one party of his right to invoke set-off does not preclude the other

⁶¹ 289.

⁶² 289.

⁶³ 289.

⁶⁴ 293: “the arrangement was in effect the partial exercise of [the right to set-off] from time to time; nor was it inconsistent with an intention to retain that right in future.”

⁶⁵ *Hardy NO v Harsant* 1913 TDP 433 447.

⁶⁶ See ch 3 (3 4 1).

⁶⁷ See 4 2 2 2 above.

⁶⁸ *Southern Cape Liquors (Pty) Ltd v Delipcus Beleggings BK* 1998 4 SA 494 (C); *Hardy NO v Harsant* 1913 TPD 433.

party from relying on set-off. Waiver of a right causes that right to perish⁶⁹ and is irrevocable.⁷⁰ It is thus important for a party to be aware when he will legally have waived his right to set-off, as this will preclude any future reliance by him on set-off in respect of that debt. This requires us to consider the general principles that determine the nature and requirements of waiver

4 3 2 Nature and requirements of waiver

Unanimity on the precise nature of waiver has not been reached in South African law.⁷¹ One view is that waiver is based on an agreement, in terms of which one party offers to waive its right and the other party accepts such a waiver.⁷² This view is supported by Christie and Bradfield in so far as the waiver relates to a contractually conferred right.⁷³ The requirements for waiver in terms of this view are that (i) the person who waives his right must be fully aware of the right he is waiving;⁷⁴ (ii) he must communicate his intention to waive to the other party; and (iii) the person to whom the waiver is communicated must also be aware of the right at the time of such communication.⁷⁵

Another school of thought describes waiver as “a unilateral decision not to avail oneself of a right or a remedy, a privilege or power, an interest or benefit.”⁷⁶ All that is required for a party to waive a right is that: (i) he must be fully aware of the right that is waived;⁷⁷ and (ii) he must communicate the waiver to the other party⁷⁸ or there must be “some unequivocal act indicating a waiver.”⁷⁹ Proponents of the first mentioned school of

⁶⁹ *Mutual Life Insurance Co of New York v Ingle* 1910 TS 540 550; *Botha (now Griessel) v Finanscredit (Pty) Ltd* 1989 3 SA 773 (A) 792.

⁷⁰ *Glaser v Millward* 1950 4 SA 587 (W); Christie & Bradfield *Law of Contract* 456.

⁷¹ MFB Reinecke, JP van Niekerk & PM Nienaber “Insurance: Part 2” in WA Joubert & JA Faris (eds) *The Law of South Africa* 12(2) 2 ed (2012) para 160.

⁷² *Regent Insurance Co Ltd v Maseko* 2000 3 SA 983 (W) 995; *Napier NO v Van Schalkwyk* 2004 3 SA 425 (W) 437-438; *Union Free State Mining and Finance Corporation Ltd v Union Free State Gold and Diamond Corporation Ltd* 1960 4 SA 547 (W) 549-550. Also see GF Lubbe & CM Murray *Farlam and Hathaway Contract: Cases, Materials and Commentary* 3 ed (1988) 728-729 n 1.

⁷³ *Law of Contract* 456.

⁷⁴ Reinecke et al “Insurance: Part 2” in *LAWSA* 12(2) para 160.

⁷⁵ Reinecke et al “Insurance: Part 2” in *LAWSA* 12(2) para 160; De Wet & Van Wyk *Kontraktereg* 1 453.

⁷⁶ AJ Kerr *The Principles of the Law of Contract* 6 ed (2002) 464.

⁷⁷ Reinecke et al “Insurance: Part 2” in *LAWSA* 12(2) para 160; *Borstlap v Spangenberg* 1974 3 SA 695 (A); *Feinstein v Niggli* 1981 2 SA 684 (A) 698.

⁷⁸ *Mutual Life Insurance Co of New York v Ingle* 1910 TS 540 550.

⁷⁹ Joubert *Law of Contract* 245. Also see Kerr *Law of Contract* 465.

thought also accept the unilateral form of waiver where it involves an election or where a contractual provision which operates exclusively for the benefit of a particular contracting party is waived by that party.⁸⁰

It has been suggested that where waiver takes the form of election, for purposes of the first requirement it is merely required that the party who is alleged to have waived his right had knowledge of the material facts which give rise to the right he is waiving.⁸¹ Election by a party generally involves a waiver, in the sense that by choosing to exercise one right which is inconsistent with another right, the party is waiving the latter.⁸² Although the example used to illustrate this principle usually relates to an election regarding the possible cancellation of the agreement, it can also apply in the case of set-off: where a party elects not to invoke set-off, he waives his right to extinguish his debt by way of set-off. The argument can then be made that the fact that he was aware that mutual debts existed is sufficient, even if he was not aware that he had a right to invoke set-off. However, this seems to be contrary to the *dictum* in *Southern Cape Liquors (Pty) Ltd v Delipcus Beleggings BK*⁸³ quoted above, which clearly requires full knowledge of the right that is waived.

Whether waiver is seen as a unilateral act or an agreement, it is accepted that

“[w]aiver is first and foremost a matter of intention. Whether it is the waiver of a right or a remedy, a privilege or power, an interest or benefit, and whether in unilateral or bilateral form, the starting point invariably is the will of the party said to have waived it.”⁸⁴

Despite the fact that waiver depends primarily on the intention of the party said to waive, it is required that the intention must be communicated to the other party, either expressly or through conduct. This has been endorsed by the Appellate Division in

⁸⁰ De Wet & Van Wyk *Kontraktereg* 1 453; Lubbe & Murray *Farlam & Hathaway Contract* 731 n 5. Also see *Thomas v Henry* 1985 3 SA 889 (A) 895.

⁸¹ Reinecke et al “Insurance: Part 2” in *LAWSA* 12(2) para 160; *Feinstein v Niggli* 1981 2 SA 684 (A) 699.

⁸² *Feinstein v Niggli* 1981 2 SA 684 (A) 698; *Thomas v Henry* 1985 3 SA 889 (A) 896. Also see Lubbe & Murray *Farlam & Hathaway Contract* 731 n 5.

⁸³ 1998 4 SA 494 (C) 500.

⁸⁴ *Road Accident Fund v Mothupi* 2000 4 SA 38 (SCA) para 15.

Botha (now Griessel) v Finanscredit (Pty) Ltd,⁸⁵ where it reaffirmed the opinion by Innes CJ in *Mutual Life Insurance Co of New York v Ingle*⁸⁶ that:

“[W]aiver is the renunciation of a right. When the intention to renounce is expressly communicated to the person affected he is entitled to act upon it, and the right is gone. When the renunciation, though not communicated, is evidenced by conduct inconsistent with the enforcement of the right, or clearly showing an intention to surrender it, then also the intention may be acted upon, and the right perishes. But a mere mental resolve, not so evidenced, and not communicated to the other party, but discovered by him afterwards, seems to me... to have no effect upon the legal position of the person making the resolve”.⁸⁷

It was further confirmed in *Road Accident Fund v Mothupi*⁸⁸ that an objective test is applied to determine whether the party had the intention to waive.⁸⁹ This test is threefold: (i) the intention to waive is adjudged by its outward manifestation;⁹⁰ (ii) mental reservations which are not communicated have no legal consequence;⁹¹ and (iii) the outward manifestation of intention is evaluated from the perspective of the reasonable person in the shoes of the person relying on the waiver.⁹² The outward manifestation of a party's intention can consist of words or other conduct from which the intention to waive can be inferred.⁹³ This can also include inaction or silence in certain circumstances.⁹⁴ Although the court in *Road Accident Fund v Mothupi*⁹⁵ limits these circumstances to instances where a duty to act or speak exists, Kerr argues that there are clearly circumstances where waiver can be inferred based on inaction or silence even in the absence of a duty to speak or act.⁹⁶

⁸⁵ 1989 3 SA 773 (A) 792.

⁸⁶ 1910 TS 540.

⁸⁷ 550.

⁸⁸ 2000 4 SA 38 (SCA).

⁸⁹ Para 16, with reference to *Palmer v Poulter* 1983 4 SA 11 (T) 20C - 21A; *Multilateral Motor Vehicle Accidents Fund v Meyerowitz* 1995 1 SA 23 (C) 26H - 27G; *Bekazaku Properties (Pty) Ltd v Pam Golding Properties (Pty) Ltd* 1996 2 SA 537 (C) 543A - 544D.

⁹⁰ *Road Accident Fund v Mothupi* 2000 4 SA 38 (SCA) para 16, with reference to *Traub v Barclays National Bank Ltd*; *Kalk v Barclays National Bank Ltd* 1983 3 SA 619 (A) 634H - 635D; *Botha (now Griessel) v Finanscredit (Pty) Ltd* 1989 3 SA 773 (A) 792B - E.

⁹¹ *Road Accident Fund v Mothupi* 2000 4 SA 38 (SCA) para 16, with reference to *Mutual Life Insurance Co of New York v Ingle* 1910 TS 540 550.

⁹² Para 16.

⁹³ *Road Accident Fund v Mothupi* 2000 4 SA 38 (SCA) para 16; *Mutual Life Insurance Co of New York v Ingle* 1910 TS 540 550.

⁹⁴ *Road Accident Fund v Mothupi* 2000 4 SA 38 (SCA) para 18.

⁹⁵ Para 16.

⁹⁶ Kerr *Law of Contract* 475.

It is commonly accepted in our law that the onus is on the party who alleges waiver⁹⁷ to show that the other party “with full knowledge of [his] right, decided to abandon it, whether expressly or by conduct plainly inconsistent with an intention to enforce it.”⁹⁸ A court will not easily infer waiver, the conduct must be unequivocal.⁹⁹

4 3 3 Tacit waiver in the context of set-off

As discussed above, it is accepted that a party can waive his right to rely on set-off.¹⁰⁰ However, an important practical question is when he will be deemed to have tacitly waived his right based on his conduct. In other words, in the absence of an express or intentional waiver, when will a party run the risk of being deemed to have waived his right to rely on set-off? It is impossible to provide a complete list of the types of conduct which could indicate an intention not to invoke set-off, but it is submitted that two specific scenarios pose this risk: first, where the party delays invoking set-off; and secondly, if he either accepts partial settlement of a debt or partially settles a debt which is susceptible to set-off.

These considerations are especially relevant in the context of banking relationships. Due to different practical considerations, banks will often decide not to apply set-off at the moment that the requirements have been met, but rather to postpone its operation to a later stage. In the previous chapter, the facts of *Standard Bank of South Africa Ltd v Echo Petroleum CC*¹⁰¹ were discussed, where a client operated two accounts at the bank, the one having a credit balance and the other being overdrawn.¹⁰² By allowing the client to operate the bank accounts in this manner while the balance of both accounts are due and payable (and the other requirements for set-off are met) instead of applying the credit balance to discharge the debit balance, the bank postponed the operation of set-off. In such a case, the question must be asked whether the bank, through allowing the effluxion of time, waived its right to rely on set-

⁹⁷ Kerr *Law of Contract* 475-476; *Regent Insurance Co Ltd v Maseko* 2000 3 SA 983 (W) 997.

⁹⁸ *Law v Rutherford* 1924 AD 261 263.

⁹⁹ *Schierhout v Union Government (Minister of Justice)* 1926 AD 286 293; *Road Accident Fund v Mothupi* 2000 4 SA 38 (SCA) para 19. Also see 4 3 3 1 below.

¹⁰⁰ *Southern Cape Liquors (Pty) Ltd v Delipcus Beleggings BK* 1998 4 SA 494 (C).

¹⁰¹ 2012 5 SA 283 (SCA).

¹⁰² See ch 3 (3 4 2 4).

off. If so, what period of time must have lapsed before the bank could be said to have waived its right?

In the scenario above, the bank will presumably also allow the client to withdraw funds from the credit account. This is also what happened in *Standard Bank of South Africa Ltd v Echo Petroleum CC*.¹⁰³ In legal terms, the bank is repaying money owed to the client, despite the fact that these funds are susceptible to set-off. Thus the second question arises, namely whether the bank by allowing the client to withdraw funds in respect of which set-off could operate, waived its right to invoke set-off? Furthermore, was such a waiver only in respect of the amount withdrawn by the client or in respect of the total amount susceptible to set-off?

4 3 3 1 Delay in invoking set-off

A mere delay in enforcing a right does not necessarily constitute waiver, but is merely a factor to take into consideration in determining whether there was an intention to waive.¹⁰⁴ In *Mahabeer v Sharma NO*¹⁰⁵ Hefer JA confirmed that:

“Apart from the law relating to prescription, there is no principle in South African law ... that justifies a conclusion that a right may be lost through mere delay to enforce it”.¹⁰⁶

This seems to correspond with the court’s view in *Standard Bank of South Africa Ltd v Echo Petroleum CC*¹⁰⁷ where, despite the lapse of several months, it was held that the right to rely on set-off had not been waived. Innes CJ further confirmed in *Schierhout v Union Government (Minister of Justice)*¹⁰⁸ that:

“[W]aiver is never presumed: it must be clearly proved. Voet (16.2, par.3) remarks that even if a debtor has not set off when entitled to do so, he is not on that account to be taken to have remitted the debt, since there might be other reasons for his conduct. He adds that frequent omissions to take advantage of set-off without any probable reason might be proof of an intention to remit”.¹⁰⁹

¹⁰³ 2012 5 SA 283 (SCA).

¹⁰⁴ *Alfred McAlpine & Son (Pty) Ltd v Transvaal Provincial Administration* 1977 4 SA 310 (T) 325; Christie & Bradfield *Law of Contract* 460.

¹⁰⁵ 1985 3 SA 729 (A).

¹⁰⁶ 736D.

¹⁰⁷ 2012 5 SA 283 (SCA).

¹⁰⁸ 1926 AD 286.

¹⁰⁹ 293.

What the circumstances are that will justify an inference of waiver, will depend on the facts of each case. However, in the light of the principle laid down in *Mahabeer v Sharma NO*,¹¹⁰ it can be argued that in the absence of any other steps taken by the party said to waive his right (such as accepting payment of a debt), the other party will find it very difficult to prove that the former has waived his right to invoke set-off merely based on a lapse of time, even if it covers a substantial period.

In the banking scenario described above, the bank will in all likelihood continue to charge interest separately on the two accounts. In the absence of contractual provisions, it can be argued that this is an indication of the bank's intention not to invoke set-off, but to rather view the two accounts as separate and distinct. However, it has been said that:

“As it is by operation of law that set-off comes into effect and not by the act of parties, it can make no differen[c]e what entries the Bank made in its books on[c]e it had intimated to the plaintiff that it intended to set-off.”¹¹¹

There is some scope for the argument that charging interest amounts to no more than an accounting entry in the books of the bank, and it does not constitute an unequivocal act which indicates waiver. However, once such interest is communicated to the client in a statement, this could be taken as an indication that the bank regards the accounts (and therefore the two debts) as separate.¹¹² Whether the bank will be held to have waived its right to invoke set-off due to the charging of interest separately on the two accounts has yet to be tested in the courts.

4 3 3 2 *Accepting partial settlement of debt or partially settling a debt*

A second question is whether a party is deemed to waive his right to rely on set-off where he partially pays a debt which is susceptible to set-off, or partially accepts a payment of such a debt. Although this question is less important with regards to that portion of the debt which is settled through payment, it can have an impact on the

¹¹⁰ 1985 3 SA 729 (A).

¹¹¹ *Bain v Barclays Bank (DC & O) Ltd* 1937 SR 191 204.

¹¹² Derham argues that charging interest separately is not inconsistent with the right of banks to apply set-off, and ascribes this to an agreement between the bank and the client that, “while an account retains a separate identity in the bank's book, interest is to be calculated by reference to the balance on that account” (R Derham *The Law of Set-Off* 3 ed (2003) 656).

party's right to invoke set-off in respect of the balance of the debt which has yet to be settled.

This issue was briefly considered in *Southern Cape Liquors (Pty) Ltd v Delipcus Beleggings BK*.¹¹³ The court stated that if a person mistakenly pays a debt in respect of which set-off could operate, the payment may be reclaimed with the *condictio indebiti*.¹¹⁴ This indicates that the fact that payment was made does not automatically exclude the possibility of set-off operating – it is because the debt was discharged by set-off (despite payment of the debt) that the debtor has an enrichment claim for the payment made instead of having to rely on the original indebtedness.

Although the court did not exclude the possibility that paying a debt could amount to waiver of the right to invoke set-off, Van Zyl J stated that:

“Die hof a quo het voorts gefouteer deur te bevind dat die betaling deur die verweerder nie versoenbaar was met enige bedoeling om hom op skuldvergelyking te beroep nie. Dit beteken dat die hof tevrede was dat die verweerder afstand gedoen het van sy reg om op skuldvergelyking staat te maak. Soos reeds vermeld moet daar aan streng vereistes voldoen word alvorens so 'n afleiding gemaak kan word... Daar is geen aanduiding dat hy in daardie stadium enigsins gedink het aan die reg wat hy het om hom op skuldvergelyking te beroep nie. Nog minder is daar enige aanduiding dat hy kennis gedra het van die inhoud van sodanige reg, om nie te praat van 'volle kennis' nie. Die blote feit van betaling beteken nie dat hy van sodanige reg afstand gedoen het nie.”¹¹⁵

From the above it can be deduced that making payment of a debt in ignorance of the right to invoke set-off will not in itself amount to waiver of that right;¹¹⁶ at the very least the person alleging waiver will have to prove that the other party had knowledge of the right to invoke set-off. Furthermore, the *dictum* confirms the fact that waiver is not easily inferred.

¹¹³ 1998 4 SA 494 (C) 500-501.

¹¹⁴ 501B-C. Also see *Bain v Barclays Bank (DC & O) Ltd* 1937 SR 191 204.

¹¹⁵ 501G-I: “The court a quo further erred in finding that payment by the defendant was irreconcilable with any intention to rely on set-off. This means that the court was satisfied that the defendant waived his right to rely on set-off. As already mentioned strict requirements must be met before such an inference can be drawn... There is no indication that he at that stage thought at all about the right that he has to rely on set-off. There is even less of an indication that he had knowledge of the content of such a right, not to mention ‘full knowledge’. The mere fact of payment does not mean that he waived such a right” (own translation).

¹¹⁶ This is also confirmed in Christie & Bradfield *Law of Contract* 495.

The possibility of claiming ignorance might not be of much use to a bank, since a financial institution will find it difficult to argue that it had no knowledge of its right to apply set-off. Unfortunately, in *Standard Bank of South Africa Ltd v Echo Petroleum CC*,¹¹⁷ the facts of which were discussed previously,¹¹⁸ the question of waiver of the right to invoke set-off did not arise, despite the bank allowing the client to operate the bank account as usual after the requirements for set-off were met. This could perhaps be attributed to a failure by the defendant to allege waiver, and does not exclude the possibility that allowing withdrawals might be sufficient grounds to prove waiver of the right to invoke set-off.

Presumably, accepting partial payment of a debt which is susceptible to set-off will constitute less grounds for inferring waiver. This is because in most cases no or very little positive action is required by the payee, and accepting payment can thus be argued to be less of an indication of his intention. However, as in the case of a bank allowing a withdrawal of funds, it remains to be seen whether a court will find it sufficient grounds for finding that a party has waived his right to rely on set-off.

4 3 4 Prejudice to third parties where reliance on set-off is waived

A last relevant consideration in the context of waiver is whether a party will be allowed to waive any reliance on set-off where such a waiver will negatively affect the rights of third parties, such as a surety or where the debtor is jointly and severally liable with other co-debtors. This is again similar to the principles applied where the operation of set-off is excluded by agreement¹¹⁹ – the debtor and creditor cannot prejudice a surety in such a manner without his consent, and he will therefore still enjoy the benefit of set-off.¹²⁰

The same problem will not arise where there are jointly and severally liable co-debtors. As discussed previously,¹²¹ the predominant view is that such co-debtors are not able to rely on set-off in respect of a debt between the creditor and another co-debtor. Set-

¹¹⁷ 2012 5 SA 283 (SCA).

¹¹⁸ See ch 3 (3 4 2 4).

¹¹⁹ See 4 2 above.

¹²⁰ However, see *Dominick v Nedbank Limited* (20463/14) 2015 ZASCA 160 (13 November 2015), where it was found that not exercising a contractual right to set-off does not amount to prejudice towards the surety. Also see the discussion in 4 2 2 1 above.

¹²¹ See ch 3 (3 2 and 3 4 2 1).

off can only operate where it is relied on by either the creditor or the relevant co-debtor. Because there is no obligation on the debtor who is able to invoke set-off to do so, he cannot by waiving his right to set-off be said to prejudice the other co-debtors.

To conclude: although it is accepted that a party can waive his right to rely on set-off, the principles surrounding such a waiver are not very clear. Once again the *ipso iure* approach to set-off creates complications, especially where the right to set-off is waived after the debts were susceptible to set-off. A further difficulty in stipulating when a party will be deemed to have tacitly waived his right to invoke set-off is that the answer will depend on the facts of each case, and to date few possible scenarios have been tested in court.

4 4 Estoppel

4 4 1 Introduction

Where a person successfully relies on estoppel, he is precluded “from denying the truth of a representation previously made by him or her to another person if the latter, believing in the truth of the representation, acted thereon to his or her prejudice.”¹²² In the context of set-off, the party against whom estoppel is raised successfully would not be allowed to aver that the debt had been extinguished by set-off.

The elements which the party relying on the estoppel must prove are: (i) that he was misled by a representation made by the other party; (ii) that the belief was reasonable; and (iii) that he acted on the misrepresentation to his detriment.¹²³ Fault may also be required,¹²⁴ but the law is not clear on whether this is indeed a requirement.¹²⁵

4 4 2 The requirements of estoppel within the context of set-off

The first requirement of estoppel is that a representation must be made. It is possible that silence or inaction can constitute a representation, but only where there is a duty to speak or act.¹²⁶ In the context of set-off, it is difficult to imagine a duty to make the

¹²² PJ Rabie & H Daniels “Estoppel” in WA Joubert (ed) *The Law of South Africa* 9 2 ed (2006) para 652.

¹²³ JC Sonnekus *Rabie and Sonnekus The Law of Estoppel in South Africa* 3 ed (2012) 48; Rabie & Daniels “Estoppel” *LAWSA* 9 paras 656-671; Joubert *Contract* 82.

¹²⁴ Joubert *Contract* 82; Sonnekus *Law of Estoppel* 241-281

¹²⁵ Sonnekus *Law of Estoppel* 242.

¹²⁶ *Martin v De Kock* 1948 2 SA 719 (A); Rabie & Daniels “Estoppel” *LAWSA* 9 para 656.

other party aware of the intention to invoke set-off so that, in the absence of such communication, a party can be estopped from relying on set-off. Therefore, the representation will have to take the form of words or conduct, and merely allowing a lapse of time cannot be said to constitute a representation. Actions that will possibly meet the requirement of a representation includes steps taken to collect a debt which is susceptible to set-off, accepting partial payment or allowing the partial withdrawal of funds (in the case of a bank) or a bank sending a statement which indicates that interest was charged separately on two accounts which could be set off against each other (inasmuch as it does not in any event amount to waiver of the right to set-off).¹²⁷

The requirement that the person pleading estoppel must establish that he acted on the representation and thereby altered his position to his detriment might be problematic in the context of set-off.¹²⁸ Where the one party believed, based on a reasonable impression created by the other party, that the latter would not invoke set-off, he has two possible courses of action. Either he can decide to claim set-off, in which case the other party's decision not to rely on set-off will have no effect. Alternatively, he can decide to ignore the operation of set-off by paying his debt or by taking steps based on the other party's default, such as attempting to collect the debt owed to him.

The possibility of prejudice only arises if the second action is taken. The question is therefore whether A be prejudiced where he was under the impression that B will not rely on set-off and, based on that belief, either (i) paid the debt and now has to rely on the *condictio indebiti* to recover his claim; or (ii) took steps pursuant to the breach (e.g. by instituting action to collect the debt or taking steps to evict B where B was in default with lease payments), only to have B's default retrospectively cured due to the operation of set-off. In order to answer this, it is first necessary to ascertain what will constitute sufficient prejudice to support a defence of estoppel – a question which has been a point of some debate in our law.

In *Peri-Urban Areas Health Board v Breet NO*¹²⁹ it was held that

¹²⁷ See 4 3 above.

¹²⁸ Rabie & Daniels "Estoppel" *LAWSA* 9 para 661.

¹²⁹ 1958 3 SA 783 (W).

“the very act of the one contracting party in entering into the contract in reliance on the other’s conduct will be regarded in most bilateral contracts as a sufficient alteration of his position to his detriment to meet the requirement of prejudice... That, however, does not alter the fact that the party relying on the principle must show some kind of prejudice, even of the minimum kind just mentioned”¹³⁰

Joubert argues that the first sentence quoted above reduces the requirement of prejudice so much that it will always be present and can therefore be ignored for all practical purposes.¹³¹ However, Sonnekus does not agree and is of the view that it merely indicates that prejudice is not limited to direct or instantaneous loss, but that showing a prospect of pecuniary loss, which does not need to be easily calculable, will suffice.¹³² He further argues that a bilateral contract will as a matter of course entail an obligation which will be of patrimonial nature.¹³³ He states that:

“although academic writers on the law have suggested in law journals that the law does not, or ought not to, require that prejudice must be of a patrimonial nature in order to be capable of founding an estoppel, there is no case in which it has been held that prejudice need not be of a patrimonial nature.”¹³⁴

Where a party paid a debt which was susceptible to set-off, such a payment will either discharge the debt or possibly (where set-off is held to operate automatically) give rise to a claim of unjustified enrichment.¹³⁵ The party who made payment will therefore still be entitled either to enforce the original debt owed to him or to claim back the amount he paid with the *condictio indebiti* if he can prove the requirements for the *condictio indebiti*. If either of these possibilities is available, it is difficult to imagine any prejudice suffered on that account.

However, the scenario must also be considered here that the party who made the payment cannot prove that the requirements for the *condictio indebiti* have been satisfied, for instance where he cannot prove that his mistake in making the undue payment is excusable.¹³⁶ For example, A pays a debt to B based on his misconception

¹³⁰ 790.

¹³¹ Joubert *Contract* 82.

¹³² Sonnekus *Law of Estoppel* 199.

¹³³ 203.

¹³⁴ 199.

¹³⁵ See ch 3 (3 4 2 4).

¹³⁶ See *Willis Faber Enthoven (Pty) Ltd v Receiver of Revenue* 1992 4 SA 202 (A) 223-224, where it was confirmed that an amount paid *indebite* in mistake of fact or mistake of law can be recovered with the *condictio indebiti*, except where the payer was found to have been “inexcusably slack”.

that B will not invoke set-off. B then alleges that set-off occurred automatically before the payment was made by A. If the court adheres to the *ipso iure* construction of set-off, A has to reclaim the payment made with an enrichment claim. If he cannot prove that the requirements for this claim is satisfied, this claim will fail. Not being allowed either to claim the debt owed by B (because it has been discharged by set-off) or to reclaim the amount paid to B (because the requirements for the *condictio indebiti* cannot be proved) should constitute sufficient prejudice for purposes of estoppel. Provided the other requirements for estoppel are satisfied, A should be able to claim in the alternative that B is estopped from invoking set-off, thus allowing A to claim B's original indebtedness.

In respect of the steps taken to collect the debt, and the costs incurred to do so, there is perhaps a stronger case to be made that the party acted to his detriment, believing the other will not invoke set-off. It is also conceivable that a lessor can take steps to evict a lessee, and cancellation of the lease agreement is later disputed due to the possibility of set-off operating. See for instance the facts of *Southern Cape Liquors (Pty) Ltd v Delipcus Beleggings BK*.¹³⁷ There, the lessor did not raise the defence of estoppel, and it is difficult to say whether he would have succeeded with such a defence.

A further obstacle in the way of the party alleging estoppel might be the requirement of fault. Although it is settled that fraud is not required to found estoppel, the law is not settled with regards to whether negligence must be proved.¹³⁸ It has been indicated that fault (in the form of negligence) is not always required, although it usually must be shown in order to succeed with a defence of estoppel.¹³⁹ According to Sonnekus, "[i]f no blameworthiness can be attributed to the estoppel denier, no estoppel can be founded."¹⁴⁰ As there is no duty to invoke set-off, and both parties are entitled to rely on set-off, it might be difficult to establish fault.

¹³⁷ 1998 4 SA 494 (C). These facts are also discussed in ch 3 (3 4 2 6).

¹³⁸ Rabie & Daniels "Estoppel" LAWSA 9 para 665; Sonnekus *Law of Estoppel* 241-242.

¹³⁹ *Johaadien v Stanley Porter (Paarl) (Pty) Ltd* 1970 1 SA 394 (A); Joubert *Contract* 82 n 89; Rabie & Daniels "Estoppel" LAWSA 9 para 665.

¹⁴⁰ Sonnekus *Law of Estoppel* 242.

It is evident that a party will find it difficult to estop another from invoking set-off. Even though prejudice in this context has a wide connotation and is not limited to immediate monetary loss,¹⁴¹ this might still be difficult to show in the context of set-off. If fault on the part of the estoppel denier is required, it will further hinder successfully estopping the other. The onus will also be on the party relying on estoppel to plead and prove estoppel.¹⁴²

Lastly, it must be mentioned that once again the *ipso iure* view of set-off does not fit in well with the notion of estoppel. If a party successfully relies on estoppel, the other party “may be bound by a representation constituted by conduct”¹⁴³ and therefore be precluded from invoking its right to set-off. However, in terms of the aforementioned view, set-off operates automatically without requiring any action on the part of either of the parties.¹⁴⁴ It is thus uncertain whether estoppel can have any effect, as set-off operates by law and the party is not required to do anything to bring it about. A similar problem does not arise if the approach is followed that a declaration is required for set-off to operate, since in those circumstances it is required that a party declares set-off before it can become effective. Therefore, if the person created the impression that he would not declare set-off, he will be estopped from doing so.

4 5 Conclusion

It is clear that the law favours the autonomy of parties and that it therefore will not allow set-off to operate where the parties do not wish it to.¹⁴⁵ Parties are allowed to contract out of the operation of set-off, and the right to invoke set-off can also be waived. If it is accepted that a party can waive his right to invoke set-off, the other party should also be able to estop the former from relying on set-off where he created the reasonable belief that he will not invoke set-off. The application of the general principles relating to waiver and estoppel will largely depend on the facts of each case. It is still uncertain

¹⁴¹ Rabie & Daniels “Estoppel” *LAWSA* 9 para 663.

¹⁴² Para 672.

¹⁴³ *Concor Holdings (Pty) Ltd t/a Concor Technicrete v Potgieter* 2004 6 SA 491 (SCA).

¹⁴⁴ CG Hall *Maasdorp’s Institutes of South African Law 3: The Law of Contracts* 9 ed (1978) 412; De Wet & Van Wyk *Kontraktereg* 1 273, 282; Van der Merwe et al *Contract* 473-474.

¹⁴⁵ Voet *Commentarius ad Pandectas* 16 2 2, 16 2 6 tr P Gane *The Selective Voet being the Commentary on the Pandects by Johannes Voet and the Supplement to that Work by Johannes van der Linden* 3 (1956) 149-150, 155-156; *Southern Cape Liquors (Pty) Ltd v Delipcus Beleggings BK* 1998 4 SA 494 (C); *Hardy NO v Harsant* 1913 TDP 433; Van der Merwe et al *Contract* 470; Christie & Bradfield *Law of Contract* 495.

how willing the courts will be to accept these defences in the context of set-off and what conduct will be regarded as sufficient grounds for the conclusion either that a party has waived his right to invoke set-off or that he should be estopped from doing so.

Even though the possibility of excluding the operation of set-off is universally accepted, analysing the ways in which this may happen once again highlights the problems with according it automatic operation. Despite the basic principle of the *ipso iure* approach to set-off being that the debts are extinguished by law, without depending on any action by or wish of the parties, this is irreconcilable with the principle of freedom of contract and is therefore not consistently adhered to.

It is thus evident that the theoretical principles underlying the exclusions of the operation of set-off favour the view that a declaration is required for set-off to operate. This approach makes it clear on what basis exceptions to the operation of set-off are allowed – the parties either agree not to declare set-off, or one party waives his right to do so, or is estopped from declaring set-off. Requiring a declaration further avoids a situation where the law regards a debt as already extinguished (due to the automatic operation of set-off), but a party is then still allowed to exclude or waive the operation of set-off. Attempts to rationalise this situation lead to agreements being inferred on grounds which are insufficient at best – based on convenience rather than the satisfaction of the requirements for a valid contract – and therefore cause a distortion of the concept of a tacit agreement.

CHAPTER 5: THE IMPACT OF THE NATIONAL CREDIT ACT ON SET-OFF

5.1 Introduction

The previous chapters focused on the historical origin of set-off, and provided an analysis of the current principles governing this form of debt extinction. We have also seen that the operation of set-off can be excluded or varied in certain circumstances, whether by agreement, waiver and possibly estoppel.

In many legal systems the general principles governing the operation of set-off have been regarded as inadequate when applied to credit agreements.¹ South African law is no exception. According to sections 90 and 124 of the National Credit Act 24 of 2005 (NCA), if a credit provider wants to insert a clause into a credit agreement which authorises the appropriation of money from an account of a debtor to satisfy an obligation in terms of a credit agreement, such an authorisation must comply with certain requirements. Prescribing conditions for utilising money in one account of a client to settle or reduce the indebtedness of that client in terms of another account, will affect the right of a credit provider to rely on set-off.

However, uncertainty exists regarding the ambit of the abovementioned provisions, and specifically their impact on a credit provider's common law right to set-off. This chapter will analyse whether these provisions of the NCA exclude a credit provider's common law right to set-off, by considering (i) the reports and policy documents prepared during the drafting of the NCA; (ii) provisions in consumer legislation of other jurisdictions; and (iii) the objectives of the NCA. Other provisions of the NCA will also be considered to ascertain whether a specific interpretation of sections 90(2)(n) and 124 will contravene these provisions, and the impact of the provisions contained in the Code of Banking Practice will be assessed. It will also be evaluated whether and to what extent a limitation to a credit provider's right to invoke set-off is desirable.

Although these principles will apply to any credit provider who is able to invoke set-off, they will be of particular relevance for a bank, operating as a credit provider. This is because a bank, as both a lender and a deposit-taking institution, is generally in a

¹ P Pichonnaz & L Gullifer *Set-Off in Arbitration and Commercial Transactions* (2014) 283; R Zimmermann *Comparative Foundations of the European Law of Set-Off and Prescription* (2002) 56.

position where it can invoke set-off. Other credit providers (for instance micro lenders) who only grant loans, will seldom be in the position where set-off becomes possible. Therefore, the focus in this chapter will be mainly on banks, although (with the exception of the Code of Banking Practice) the same principles will apply in the case of other credit providers.

5 2 The relevant provisions of the NCA

5 2 1 Overview of sections 90(2)(n) and 124 of the NCA

In the case of credit agreements which are subject to the NCA,² credit providers must adhere to sections 90(2)(n) and 124 of the NCA. These sections read as follows:

“90(2) A provision of a credit agreement is unlawful if-

- (n) it purports to authorise or permit the credit provider to satisfy an obligation of the consumer by making a charge against an asset, account, or amount deposited by or for the benefit of the consumer and held by the credit provider or a third party, except by way of a standing debt arrangement, or to the extent permitted by section 124;

124 Charges to other accounts

- (1) It is lawful for a consumer to provide, a credit provider to request or a credit agreement to include an authorisation to the credit provider to make a charge or series of charges contemplated in section 90(2)(n), if such authorisation meets all the following conditions-
 - (a) the charge or series of charges may be made only against an asset, account, or amount that has been-
 - (i) deposited by or for the benefit of the consumer and held by that credit provider or that third party; and
 - (ii) specifically named by the consumer in the authorisation;
 - (b) the charge or series of charges may be made only to satisfy-
 - (i) a single obligation under the credit agreement; or
 - (ii) a series of recurring obligations under the credit agreement,

² For purposes of this discussion, it is unnecessary to discuss which credit agreements are subject to the NCA. Where reference is made to a “credit agreement”, it will be assumed that such an agreement is subject to the NCA.

- specifically set out in the authorisation;
- (c) the charge or series of charges may be made only for an amount that is-
 - (i) calculated by reference to the obligation it is intended to satisfy under the credit agreement, and
 - (ii) specifically set out in the authorisation;
 - (d) the charge or series of charges may be made only on or after a specified date, or series of specified dates-
 - (i) corresponding to the date on which an obligation arises, or the dates on which a series of recurring obligations arise, under the credit agreement; and
 - (ii) specifically set out in the authorisation; and
 - (e) any authorisation not given in writing, must be recorded electromagnetically and subsequently reduced to writing.
- (2) Before making a single charge, or the initial charge of a series of charges, to be made under a particular authorisation, the credit provider must give the consumer notice in the prescribed manner and form, setting out the particulars as required by this subsection, of the charge or charges to be made under that authorisation.”

A bank will often choose to insert a so-called cross-default clause in a loan agreement with the client. This clause allows the bank, in the event of default by the client, to utilise funds held by the bank in another account of the client, in order to satisfy the outstanding loan payment or payments. However, in terms of section 90(2)(n) of the NCA, a credit provider is not allowed to insert a blanket provision authorising the bank to appropriate any funds held on behalf of the client in the event of default. If a credit provider wants to insert a provision authorising the collection of funds, it must comply with specific conditions prescribed in section 124 of the NCA. The authorisation must therefore be specific as to the account from which the funds can be withdrawn,³ the obligation which may be satisfied,⁴ the amount which may be appropriated⁵ and the

³ S124(1)(a).

⁴ S 124(1)(b). Form 27 of the Regulations to the NCA sets out the prescribed form for the notice.

⁵ S 124(1)(c).

date on which the funds may be utilised.⁶ This authorisation can be given upon the consumer's own initiative, in response to a request by the credit provider or it can be included in a credit agreement.⁷ This means the credit provider can, after conclusion of the credit agreement, still obtain the necessary authorisation from the client. The credit provider is only allowed to collect money from an account of the client in accordance with this authorisation, and it further has to give notice to the consumer before doing so.⁸

An example of such an authorisation will be where the client authorises the bank to collect R100 from account X on the 25th of every month. The bank, after giving the required notice, is allowed to collect funds in accordance with the authorisation. However, the problem arises if the bank attempts to collect on 25 May, but finds that there is only R40 in account X. The bank will not be allowed to collect the shortfall of R60 from account Y also held by the client. Neither may the bank collect the shortfall on 26 May, nor collect R160 on 26 June, as none of these measures are in accordance with the authorisation. A clause in the credit agreement which allows the bank to deviate from the authorisation in the event of default will contravene section 124.

To understand how the abovementioned sections of the NCA limit the application of set-off by a bank (who qualifies as a credit provider in terms of the NCA⁹) in respect of a debt owed in terms of a credit agreement, two aspects need to be considered. First, the nature of the relationship between a bank and its client must be analysed. Secondly, it must be determined what will constitute a charge for purposes of the NCA. Once that is settled, the ambit of the provision and the effect thereof on a credit provider's common-law right to set-off can be investigated.

5 2 2 The relationship between a bank and its client

It has been mentioned previously that ownership of money deposited in a client's bank account vests in the bank, and the client retains a claim or personal right against the

⁶ S 124(1)(d).

⁷ S 124(1).

⁸ S 124(2).

⁹ See the definition of "credit provider" in s 1 of the NCA.

bank.¹⁰ The bank is therefore the client's debtor in respect of those funds.¹¹ Where the bank grants a loan to the same client, or allows an overdraft in respect of another account operated by that client, the bank is also a creditor of the client. Where both accounts are due and payable and in the absence of contractual provisions preventing set-off, the possibility exists that the bank can rely on set-off to appropriate money from the client's transactional account to settle or reduce the debit balance of the loan account.¹²

This right of a bank to invoke set-off in effect means that the bank utilises funds in one account of the client to "satisfy an obligation of the consumer".¹³ The question is whether this appropriation of funds will constitute a charge made against an account of the client, as contemplated in the NCA.

5 2 3 The meaning of a "charge" in terms of the NCA

The term "charge" is not defined in the NCA, but is mainly used as an equivalent to costs or fees.¹⁴ In that context it has been said that the word "charge" should be interpreted widely.¹⁵

However, it is generally accepted that "charge" in the context of sections 90(2)(n) and 124 refers to the appropriation or withdrawal of any funds from an account, for instance by way of a debit order.¹⁶ According to Otto and Otto

¹⁰ See ch 3 (3 4 2 4). Also see *Ormerod v Deputy Sheriff, Durban* 1965 4 All SA 330 (D) 334, with reference to *White v Standard Bank* 1883 4 N.L.R. 88 91-92; *Herrigel NO v Bon Roads Construction Co (Pty) Ltd* 1980 4 SA 669 (SWA) 674B-C; *Dantex Investment Holdings (Pty) Ltd v National Explosives (Pty) Ltd (In Liquidation)* 1990 1 SA 736 (A) 478F-G; *Standard Bank of South Africa Ltd v Echo Petroleum CC* 2012 5 SA 283 (SCA) 287-288; *ABSA Bank Ltd v Intensive Air (Pty) Ltd* 2011 2 SA 275 (SCA) 279. The fact that the client is not the owner of money standing to his credit in his bank account is also confirmed in J du Plessis *The South African Law of Unjustified Enrichment* (2012) 34-35; *Gainsford NNO v Gulliver's Travel (Bruma) (Pty) Ltd* (07/ 5121) [2009] ZAGPJHC 20 (7 April 2009) paras 99-100.

¹¹ *Gainsford NNO v Gulliver's Travel (Bruma) (Pty) Ltd* (07/ 5121) [2009] ZAGPJHC 20 (7 April 2009) para 100.

¹² J Pretorius "Combining Bank Accounts" (2008) 16 *JBL* 51 53.

¹³ See the wording of s 90(2)(n) above.

¹⁴ See for instance Part C in Chapter 5 of the NCA.

¹⁵ JM Otto & R-L Otto *The National Credit Act Explained* 3 ed (2013) 89 n 2. Also see *Evans v Smith* 2011 4 SA 472 (WCC) para 16, where Binns-Ward J stated that: "The terms 'charge', 'fee' and 'interest' are not defined in the NCA. They therefore fall to be construed in accordance with the ordinary meaning of the words as they would be understood in the context in which they have been employed in the statute."

¹⁶ JW Scholtz, JM Otto, E van Zyl, CM van Heerden & N Campbell *Guide to the National Credit Act* (2008) 9-13 n 55.

“[w]hat is clearly prohibited is a clause in a contract which generally authorises the credit provider to satisfy a debt out of any account that the consumer has with it”.¹⁷

As described above, when a bank exercises its right to set-off, funds in one account of a client are used to reduce or settle a debt in another account, without the client instructing the bank to do so. There is little doubt that this action – appropriating funds from one account of a client to pay a debt incurred in terms of another account – falls within the ambit of the conduct regulated by sections 90(2)(n) and 124 of the NCA. This view also corresponds with the interpretation of these provisions by the National Credit Regulator (NCR).¹⁸

This is not the end of the analysis, however. The first sentence of section 90(2) does not prohibit this conduct, but rather states that a *provision* in a credit agreement authorising such conduct is unlawful. The question thus arises whether section 90(2)(n) of the NCA only relates to a provision in a credit agreement that authorises a charge against an account (and therefore set-off), or whether it also (by implication) prohibits a creditor from relying on its common-law right of set-off.

5 2 4 The debate surrounding the impact of the NCA on the common-law right to invoke set-off

Due to the uncertainty surrounding the impact of sections 90(2)(n) and 124 of the NCA on the common-law right of credit providers to invoke set-off, several South African banks obtained legal opinions in this regard. The opinion expressed by their legal advisors was that the NCA does not prohibit a credit provider from relying on its common-law right to set-off.¹⁹ According to them, the provisions of the NCA quoted above will only apply if the credit agreement contains provisions authorising the credit provider to satisfy an obligation against an account of the client. Therefore, where no

¹⁷ *The National Credit Act* 57 n 51.

¹⁸ National Credit Regulator “NCR Consumer Booklet” (2007) NCR 20 <<http://www.ncr.org.za/brochures/NCR%20Consumer%20Booklet/ENGLISH.pdf>> (accessed 30-11-2015), where the NCR interprets the clause as preventing “[p]rovisions/clauses that authorise the credit provider to set-off a consumer’s debt against an asset or account of the consumer held by the credit provider, except where the consumer has given the credit provider specific instructions specifying which assets may be set-off against which credit agreement.”

¹⁹ Ombudsman for Banking Services “Consumer Information Note 5: Set-Off” (21-07-2009) *Ombudsman for Banking Services* 3 <http://www.obssa.co.za/images/documents/cin_005_setoff.pdf> (accessed 30-11-2015).

such clause is contained in the credit agreement, section 90(2)(n) of the NCA will not apply and a credit provider can enforce its common-law right to set-off.

If the abovementioned interpretation is correct, the provisions of the NCA will apply even if the clause contained in a credit agreement does not add to the bank's common-law right to set-off in any way but merely confirms it. This gives rise to the rather strange, if not downright bizarre, situation that in order to retain its right, a credit provider must refrain from stipulating such a right in the credit agreement.

The NCR disagreed with the opinion expressed by the banks.²⁰ Although the grounds for the disagreement are not clear, it is possible that they considered such an interpretation to be inconsistent with the spirit and purposes of the NCA. However, in the absence of a definitive finding by the courts, banks continue to rely on set-off.²¹ Unfortunately, the Department of Trade and Industry failed to identify the uncertainty surrounding the application of the common-law right to set-off as one of the challenges which emerged from the NCA,²² with the result that the legislature has missed the opportunity to clarify these provisions in the National Credit Amendment Act 19 of 2014.

The Ombudsman for Banking Services was of the view that this dispute should be settled by a legislative amendment or a court judgment.²³ As neither has occurred, it is still uncertain whether the NCA will only prohibit a clause in an agreement authorising set-off, or whether a credit provider's common law right to set-off will also be affected.

At first glance it may seem as if this debate is not very significant, as a bank can acquire the authorisation contemplated in section 124 of the NCA and proceed to appropriate

²⁰ Ombudsman for Banking Services "Consumer Information Note 5: Set-Off" *Ombudsman for Banking Services* 3; W Knowler "Credit Providers' Contentious Set-Off Habit Will Soon Be Illegal" (15-09-2014) *IOL Blogs* <<http://www.iol.co.za/blogs/wendy-knowler-s-consumer-watch-1.1608/credit-providers-contentious-set-off-habit-will-soon-be-illegal-1.1751365#.VidjoNKUd8F>> (accessed 30-11-2015); W Knowler "Bank Helps Itself to Client's Money Illegally" (01-09-2015) *Times Live* <<http://www.timeslive.co.za/lifestyle/inyourcorner/2015/09/01/Bank-helps-itself-to-client%E2%80%99s-money-illegally>> (accessed 30-11-2015).

²¹ Ombudsman for Banking Services "Consumer Information Note 5: Set-Off" *Ombudsman for Banking Services* 3.

²² Department of Trade and Industry "Document In Respect of Project Re Policy Review of the National Credit Act 34 of 2005" GN 559 in GG 36504 of 2013-05-29.

²³ Ombudsman for Banking Services "Consumer Information Note 5: Set-Off" *Ombudsman for Banking Services* 3.

amounts from the account of the client in accordance with that authorisation. However, if this is done the bank will be limited in the exercise of its right to what is contained in that authorisation. As mentioned above,²⁴ this limitation pertains to the amount which may be collected²⁵, the date of collection²⁶ and the account from which is collected²⁷. It is undoubtedly preferable for a bank to rely on its more flexible common-law right to set-off, in terms of which the bank requires no authorisation and is not restricted in respect of the date, the specific account or the amount it may appropriate (although only amounts which are due and payable are susceptible to set-off). This also avoids the risk for instance of the client nominating one account in terms of section 124, but later instructing his employer to deposit his salary in another account held by him. If this happens, the bank will have to obtain another section 124 authorisation in respect of the second account.²⁸

In order to determine which interpretation of the relevant provisions contained in the NCA is correct, various factors must be considered. First, and in accordance with section 2 of the NCA, it is necessary to consider the spirit and purpose of the NCA. Secondly, the origin of the relevant sections must be determined to ascertain what the intention was with their inclusion in the NCA. It must also be examined whether similar provisions were included in the consumer protection legislation of the jurisdictions which influenced the drafting of the NCA.

The purpose of the abovementioned investigation is not only to ascertain how the relevant sections of the NCA should be interpreted, but also to determine whether a limitation on the right of banks to invoke set-off is desirable. Even if it is found that the common-law right of banks to rely on set-off is not restricted by the NCA, it should be considered whether any conditions should be imposed on the exercise of a bank's right to invoke set-off and, if so, what these conditions should be.

²⁴ See 5 2 1 above.

²⁵ S 124(1)(c) of the NCA.

²⁶ S 124(1)(d) of the NCA.

²⁷ S 124(1)(a) of the NCA.

²⁸ See 5 2 1 above.

5 3 Interpretation of sections 90 and 124 of the NCA

5 3 1 General rules regarding the interpretation of statutory provisions

As mentioned above, various factors must be considered in the interpretation of sections 90(2)(n) and 124 of the NCA. This includes attempting to ascertain what the origin and purpose of these provisions are. Two principles of interpretation must be borne in mind during this process.

The first rule relates to the proper boundaries of interpretation. Its purpose is to determine the meaning of the wording of a statutory provision. It may not be driven by what is deemed to be desirable in a specific case.²⁹ Doing so will disregard the separate roles of the judiciary and the legislature.³⁰ In other words, sight must not be lost of the ordinary meaning of the wording of a section; interpretation should be “concerned with the meaning of words without imposing a view of what the policy or object of the legislation is or should be.”³¹

Focusing on the purpose of legislation rather than its wording has been described as an exercise in determining the intention of the legislature. According to Wallis JA this description of the object of interpretation is incorrect.³² Instead, he contends that interpretation is an objective exercise.³³ He further states that:

“[i]nterpretation is the process of attributing meaning to the words used in a document, be it legislation, some other statutory instrument, or contract, having regard to the context provided by reading the particular provision or provisions in the light of the document as a whole and the circumstances attendant upon its coming into existence. Whatever the nature of the document, consideration must be given to the language used in the light of the ordinary rules of grammar and syntax; the context in which the provision appears; the apparent purpose to which it is directed and the material known to those responsible for its production.”³⁴

²⁹ *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 4 SA 593 (SCA) para 22, with reference to JJ Spigelman “The Intolerable Wrestle: Developments in Statutory Interpretation” (2010) 84 ALJ 822 826.

³⁰ *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 4 SA 593 (SCA) para 22.

³¹ *Mankayi v Anglogold Ashanti Ltd* 2010 5 SA 137 (SCA) para 25.

³² *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 4 SA 593 (SCA) paras 20, 23.

³³ Paras 18, 23.

³⁴ Para 18.

The plain meaning of a provision in combination with the context and purpose of the provisions should therefore be considered, as well as the relevant material leading to its production. With regards to the plain meaning of the provision, it must be noted that the section 90(2)(n) of the NCA clearly refers to a “*provision of a credit agreement* [which] purports to authorise or permit a credit provider”³⁵ to take certain actions, without making any reference to a common-law right which could render the same result. The heading to section 90, which reads “Unlawful provisions of credit agreement” also does not indicate an application which extends beyond declaring that certain types of provisions are unlawful. It can be argued that interpreting the provision in a way which extends its scope beyond what may be contained in a credit agreement, would cross the line between interpretation and legislation.

However, in terms of section 2(1) of the NCA, a court is required to interpret the provisions of the NCA in a manner that gives effect to the purposes of the NCA as set out in section 3.³⁶ This obligation to follow a purposive interpretation may grant the court more scope to deviate from the linguistic interpretation of a specific section of the NCA in order to promote the objectives of the NCA. These purposes are to:

“promote and advance the social and economic welfare of South Africans, promote a fair, transparent, competitive, sustainable, responsible, efficient, effective and accessible credit market and industry, and to protect consumers”.³⁷

A list of measures is provided to facilitate these objectives, which includes:

“promoting responsibility in the credit market by discouraging ... contractual default by consumers; addressing and correcting imbalances in negotiating power between consumers and credit providers by ... providing consumers with adequate disclosure of standardised information in order to make informed choices; ... [and] providing for a consistent and harmonised system of debt restructuring, enforcement and judgment, which places priority on the eventual satisfaction of all responsible consumer obligations under credit agreements.”³⁸

³⁵ Own emphasis.

³⁶ See *Nedbank Ltd v National Credit Regulator* 2011 3 SA 581 (SCA) para 2.

³⁷ S 3 of the NCA.

³⁸ Ss 3(c)(ii) and 3(e)(ii) of the NCA.

To determine which interpretation of sections 90(2)(n) and 124 would be most conducive to these purposes, it is necessary to consider the consequences of restricting the common-law right of banks to invoke set-off.

Before commencing this analysis, a second relevant rule of interpretation must be mentioned, namely that the legislature is presumed to be acquainted with the state of the law, and that includes the common law.³⁹ The common law can be amended by statutory provisions, but these provisions should not be interpreted to alter the common law more than necessary.⁴⁰ For the common law to be varied, the intention of the legislature must be plainly aimed at modifying the common law, and even in such a case the modification will only be to the extent provided for by the relevant statutory provisions (whether expressly or by necessary implication).⁴¹

Sections 90(2)(n) and 124 of the NCA make no reference to and contain no express variation of the common-law right to set-off. These sections may, if interpreted in the manner advanced by the NCR, modify the common law regarding set-off by necessary implication. However, in light of the abovementioned rules regarding interpretation, it seems as if the interpretation of the banks, namely that the relevant sections of the NCA will not affect their common-law right to set-off, will be favoured. However, in the absence of a definitive finding by the courts, this is mere speculation. It is therefore necessary to consider other factors which might influence the interpretation of these sections.

5 3 2 Considerations regarding the spirit and purposes of the NCA

The first, and probably most important, factor which must be considered is whether a limitation of a credit provider's common-law right to invoke set-off is in accordance with the spirit and purposes of the NCA. As mentioned above,⁴² this can only be done by analysing the consequences of such a limitation.

³⁹ *Terblanche v South African Eagle Insurance Co Ltd* 1983 2 SA 501 (N) 504F.

⁴⁰ *Nedbank Ltd v National Credit Regulator* 2011 3 SA 581 (SCA) para 38.

⁴¹ Para 38.

⁴² See 5 3 1 above.

5 3 2 1 *Reasons for limiting the right of banks to invoke set-off*

As a point of departure it is necessary to consider why a bank's right to invoke set-off can have an adverse impact on a consumer. In other words, it must be speculated why the legislature would have considered it necessary to restrict this right of a bank.

It is evident that set-off is a powerful mechanism in the hands of a creditor, and this is especially true in the case of a bank. Often a bank will require that its client maintains a transactional account with it when granting a loan to the client, which enables the bank to use set-off to collect arrear payments due on another account from the client's transactional account. Studies have shown that set-off between accounts (which is known informally as "money grabbing") occurs regularly.⁴³

Failure by the bank to exercise proper discretion when applying set-off can lead to gross unfairness towards the client and cause financial harm. Consider for instance a client who falls in arrears with one or two loan payments due to unforeseen circumstances. The bank, enforcing its right to set-off, appropriates amounts due from the transactional account of the client, leaving an amount insufficient for subsistence of the client and rendering the client unable to service his other debts. This can, in turn, result either in the client's other creditors accelerating the repayment of his loans or in the client having to incur additional debt (at a less favourable interest rate) to stay afloat. If the client is unaware of the reduction in the balance of his account (since notice is not required for set-off), he may also unknowingly incur the additional costs of a returned cheque or a declined debit order.

A further problem which might arise is that the client is not given the opportunity to raise any defences against the bank's claim, such as prescription.⁴⁴ In the context of prescription, this problem is prevented by section 126B(1)(b) of the NCA, which provides that a debt which has been extinguished by prescription may not be collected. However, it is conceivable that the client might also have other defences against the bank's claim (for instance if the signature on the loan document was forged). Even if

⁴³ See University of Pretoria Law Clinic "The Debt Counselling Process: Challenges to Consumers and the Credit Industry" (April 2009) NCR 293 <<http://www.ncr.org.za/documents/pages/research-reports/apr09/ncr.zip>> (accessed 30-11-2015), where it is indicated that 62% of consumers interviewed during the study indicated that they have experienced set-off between their bank accounts.

⁴⁴ Knowler "Credit Providers' Contentious Set-Off Habit Will Soon Be Illegal" *IOL Blogs*; Knowler "Bank Helps Itself to Client's Money Illegally" *Times Live*.

the client manages to have the money appropriated by set-off refunded, it does not compensate for injuries caused by the unavailability of funds, such as those mentioned in the previous paragraph.

5.3.2.2 *Adverse consequences of limiting the right to invoke set-off*

While it is clear that there is sufficient cause for introducing measures to protect a consumer from the negative effects of a bank exercising its right to set-off, it is also important to bear in mind the adverse consequences of limiting the right of credit providers to apply set-off.

Both access to credit and the cost of credit – two factors which are of crucial importance in consumer credit legislation – are closely linked to the perceived risk of granting credit. The lower the risk attached to a loan, the lower the interest rate charged by a bank. Prohibiting banks from relying on set-off to recover outstanding amounts will remove the security provided by this mechanism. This will increase the bank's risk and will thus be detrimental to the overall cost of credit.⁴⁵

An effective collection method will decrease the risk attached to a loan.⁴⁶ Set-off provides a method of collection which is not only effective, but also carries a very low cost of implementation and thus leads to a lower cost of credit. It is acknowledged in policy documents and research compiled in the course of drafting the NCA that:

“Effective debt recovery procedures would assist credit providers by reducing bad debt write-offs, and assist consumers by ensuring that high bad debts of a minority of consumers do not feed through into higher interest rates for the rest.”⁴⁷

Section 3(a) of the NCA further highlights the necessity to improve access to credit, while preventing the exploitation of consumers. The willingness of a credit provider to grant credit increases if more security is provided in respect of a loan. Thus, the

⁴⁵ See Department of Trade and Industry “Credit Law Review August 2003: Summary of Findings of the Technical Committee” (August 2003) *National Credit Regulator* 31 <http://www.ncr.org.za/documents/pages/background_documents/Summary%20of%20Findings.pdf> (accessed 30-11-2015), where it is acknowledged that “problems in the area of debt recovery and contract enforcement increase the cost of finance substantially.”

⁴⁶ See P Hawkins *The Cost, Volume and Allocation of Consumer Credit in South Africa* (2003) 55-58 for the mechanisms used to reduce the risk associated with collections.

⁴⁷ Department of Trade and Industry “Making Credit Markets Work: A Policy Framework for Consumer Credit” (November 2010) *National Credit Regulator* 7 <http://www.ncr.org.za/documents/pages/background_documents/Credit%20Law%20Review.pdf> (accessed 30-11-2015).

security function of set-off will cause a broader group of people to have access to credit through the formal banking sector.

Although conditions can be set for the exercise of a bank's right to set-off, the consequence of these conditions should be considered. For instance, requiring notification before exercising the right of set-off will enable a client to withdraw the funds susceptible to set-off after receiving the notice, but before the credit provider has exercised his right. This will result in set-off

“ceas[ing] to be the swift remedy that it is today [and banks] lacking this power ... may be less reticent to call in a depositor's loan, thereby accelerating a different kind of injury to the depositor.”⁴⁸

If the bank is allowed to invoke set-off, it will mean that the client cannot be in default while there are sufficient funds in another of his accounts with the bank to settle the outstanding payments.⁴⁹ If there are no contractual provisions to the contrary, the client would therefore be protected from the consequences of breach. For instance, the bank would not be able to invoke an acceleration clause which, if set-off could not operate, it would be able to do.

It can therefore not be said that allowing set-off by credit providers “goes against the spirit and intent of the [NCA] in all respects.”⁵⁰ Although, as mentioned above, this right can be abused, abolishing it completely would also have adverse effects. An interpretation which excludes the common-law right of banks to invoke set-off is thus not necessarily one that gives effect to the spirit and purposes of the NCA, as argued by the NCR.⁵¹

5 3 3 The origin of sections 90 and 124 of the NCA

The next factor to consider when interpreting sections 90 and 124 of the NCA is the origin of these provisions. In order to determine what the origin of the provisions is, it

⁴⁸ SL Sepinuck “The Problems with Setoff: A Proposed Legislative Solution” (1988) 30 *Wm. & Mary Law Review* 51 65.

⁴⁹ This will be the case regardless of whether set-off operates automatically or retrospectively, see ch 3 (3 4 2 6).

⁵⁰ University of Pretoria Law Clinic “The Debt Counselling Process: Challenges to Consumers and the Credit Industry” *NCR* 294.

⁵¹ See n 20 above.

is necessary to study the policy documents and reports prepared in the process of drafting the NCA and to consider the provisions in other jurisdictions which might have influenced the drafters of the NCA.

5 3 3 1 *The policy documents informing the NCA*

As mentioned above, the legislature is assumed to be circumspect when amending the common law.⁵² Where it decides to restrict an important common-law right, it would be expected that the problems which caused the legislature to consider such a restriction would be highlighted in the reports and policy documents prepared during the drafting of the legislation. However, despite the practical significance of the right of banks to rely on set-off,⁵³ the policy documents providing background to the NCA do not deal with or even mention the topic of set-off by banks.⁵⁴

There are, however, two observations by the Technical Committee (which was tasked with making recommendations regarding the NCA) which could possibly be interpreted to refer to the right to invoke set-off. The first instance is where the Technical Committee states that the credit legislation should “[i]ntroduce regulation on collection practices such as payroll deduction and banks’ treatment of debit orders ... in order to ensure that neither competition nor consumer protection are undermined”.⁵⁵ They do not elaborate upon this statement, or whether the term “collection practices” is wide enough to include collection by means of set-off.⁵⁶ How these practices undermine either competition or consumer protection is also not explained. It is thus difficult to

⁵² See 5 3 1 above.

⁵³ See n 43 above.

⁵⁴ These include the following documents: R Willemse & N Mxunyelwa *Report Prepared by Hofmeyr Herbstein & Gihwala for Purposes of the Credit Law Review* (2002); Reality Research Africa *Credit Contract Disclosure and Associated Factors: Executive Summary of Research to Determine Public Awareness of Legal Provisions in Relation to Credit and Satisfaction with Provisions for their Benefit* (2002); P Meagher *Regulation of Payday Lenders in the United States* (2003); G A Dymski *Interest Rates, Credit Structures and Usury in Emerging Markets* (2003); P Hawkins *The Cost, Volume and Allocation of Consumer Credit in South Africa* (2003); Department of Trade and Industry “Credit Law Review August 2003: Summary of Findings of the Technical Committee” *National Credit Regulator*; Rudo Research and Training & AfriData Research *A Market Research Report: Credit Law Review* (2004).

⁵⁵ Department of Trade and Industry “Credit Law Review August 2003: Summary of Findings of the Technical Committee” *National Credit Regulator* 25.

⁵⁶ See ss 90(2)(j) and 90(2)(m) of the NCA, which seems to have been included pursuant to these concerns.

draw any conclusions from this statement about the operation of the common-law right of set-off.

The second observation which may relate to set-off is where the Technical Committee identifies as one of the weaknesses in the credit legislation preceding the National Credit Act the fact that:

“Certain aspects of the Banks Act and National Payment System rules undermine competition in the consumer credit markets (while creating inequitable preferences for certain credit providers)”.⁵⁷

The specific provisions of the Banks Act 94 of 1990 which lead to these inequalities are not specified.⁵⁸ The Banks Act contains no provisions authorising banks to invoke set-off, although regulation 15⁵⁹ allows banks to report only the net balance of a client’s liability, i.e. the balance after set-off has been effected. This is only allowed if the bank has a legal right to set the balance of the client’s accounts off against each other and thus does not authorise set-off, but merely regulates one of the consequences where the common-law right exists.

None of the studies or reports considered by the Technical Committee⁶⁰ indicate that reliance on a bank’s common law right to set-off sufficiently prejudices the consumer

⁵⁷ Department of Trade and Industry “Credit Law Review August 2003: Summary of Findings of the Technical Committee” *National Credit Regulator* 7; Kelly-Louw M “Introduction to the National Credit Act” (2007) 15 *JBL* 147 148.

⁵⁸ Although it seems as if the objection raised by the Technical Committee relates to barriers of entry caused by the conditions imposed by the Banks Act 94 of 1990 for requiring a banking licence (Department of Trade and Industry “Credit Law Review August 2003: Summary of Findings of the Technical Committee” *National Credit Regulator* 21).

⁵⁹ Regulation 15 of the Regulations relating to Banks (GNR 628 in GG 17115 of 1996-04-26) reads as follows:

“(1) Where a client maintains both debit and credit balances with a bank, it may be permissible in certain circumstances to set such balances off against one another for the purposes of completing the prescribed forms, thus reporting net balances only.
(2) Unless otherwise provided in these Regulations, set-off shall be allowed only if all of the following circumstances apply, namely—
(a) a legal right of set-off must exist and the reporting bank should have obtained a legal opinion to the effect that its right to apply set-off is legally well-founded and would be enforceable in the liquidation or bankruptcy of the client(s) or of the bank;
(b) the debit and credit balances must relate to the same person;
(c) both the debit and the credit balances must be denominated in the same currency; and
(d) the debit and credit balances must have identical maturities.”

⁶⁰ For a list of the publications and reports considered, see Department of Trade and Industry “Credit Law Review: Setting the Scene” (November 2010) *National Credit Regulator* 3 <http://www.ncr.org.za/documents/pages/background_documents/Introduction-RevNo1.pdf> (accessed 30-11-2015). Also see n 54 above.

to warrant legislative intervention. To the contrary, the only explicit reference to set-off that can be found is the suggestion that limiting the consumer's right to invoke set-off might constitute an unfair term.⁶¹ This provision did not find its way into the NCA, but was partially included in the regulations to the Consumer Protection Act 68 of 2008.⁶²

It is evident that, if the South African legislature meant to regulate a credit provider's common-law right to invoke set-off, such a consideration was not contained in the policy documents. Given that the drafters were at times inspired by foreign law in incorporating certain provisions in the Act, it may be of interest to determine whether similar provisions to those found in sections 90(2)(n) or 124 of the NCA are contained in the legislation of other jurisdictions, which might have influenced the drafters of the NCA to adopt those provisions in South African law.

5 3 3 2 *Provisions in other jurisdictions regarding set-off by banks*

In accordance with section 2(2) of the NCA, appropriate foreign and international law may be considered to assist in the interpretation of the provisions of the NCA.⁶³ The NCA does not define "international law" or "foreign law", which causes some uncertainty with regards to which jurisdictions are appropriate to consider.⁶⁴ Presumably it should include those jurisdictions which were considered during the

⁶¹ See Willemse & Mxunyelwa *Report Prepared by Hofmeyr Herstein & Gihwala for Purposes of the Credit Law Review* 12, who refer to the proposed legislation contained in SA Law Reform Commission *Unreasonable Stipulations in Contracts and the Rectification of Contracts Project* 47 (1998), of which clause 2(v) states that "[i]n determining whether a contract or a term thereof is unreasonable, unconscionable or oppressive ... the court may, where applicable, take into account the following factors, namely ... (v) [w]hether the term directly or indirectly amounts to a waiver or limitation of the competence of the party against whom the term is proffered to apply set-off".

⁶² Regulation 44(3)(b) of the regulations in terms of the Consumer Protection Act 68 of 2008 (GNR 293 in GG 34180 of 2011-04-01) states that:

"(3) A term of a consumer agreement subject to the provisions of subregulation (1) is presumed to be unfair if it has the purpose or effect of—
 (b) excluding or restricting the legal rights or remedies of the consumer against the supplier or another party in the event of total or partial breach by the supplier of any of the obligations provided for in the agreement, including the right of the consumer to set off a debt owed to the supplier against any claim which the consumer may have against the supplier".

⁶³ See *Nedbank Ltd v National Credit Regulator* 2011 3 SA 581 (SCA) para 2.

⁶⁴ M Kelly-Louw *Consumer Credit Regulation in South Africa* (2012) 24.

drafting of the NCA,⁶⁵ such as the United Kingdom, the European Commission and New Zealand.⁶⁶

Investigating foreign jurisdictions serves a dual purpose: (i) it aims to identify the origin of sections 90(2)(n) and 124 of the NCA; and (ii) even if there are no similar provisions in the legislation of other jurisdictions, it will show to what extent it was found necessary in the consumer legislation of other jurisdictions to prohibit the right to set-off. The latter consideration can assist in an evaluation of whether a restriction of a bank's right to invoke set-off is desirable and should be provided for in our law.

5 3 3 2 1 United Kingdom

English law recognises a type of set-off referred to as “combination of accounts” (or merely “combination”)⁶⁷ or “current account set-off”.⁶⁸ This right allows a bank to set off a debit balance in one account against funds in another,⁶⁹ unless it is excluded contractually by the bank and its client in terms of an agreement to keep the accounts separate.⁷⁰ The same principles apply in Scotland, where a bank is allowed to combine accounts unless there is an agreement to the contrary.⁷¹

The provision of credit to consumers in the United Kingdom is regulated by the Consumer Credit Act 1974 (as amended by the Consumer Credit Act 2006). The Act contains no explicit provisions curtailing the right of credit providers to invoke set-off and no clauses similar to sections 90(2)(n) or 124 of the NCA. However, section 55A

⁶⁵ 24.

⁶⁶ Department of Trade and Industry “Credit Law Review August 2003: Summary of Findings of the Technical Committee” *National Credit Regulator* 3; M Kelly-Louw “Consumer Credit” in WA Joubert & JA Faris (eds) *The Law of South Africa* 8 3 ed (2014) para 5 n 7; M Kelly-Louw “The Prevention and Alleviation of Consumer Over-indebtedness” (2008) 20 *SA Merc LJ* 200 207 n 29.

⁶⁷ Also referred to as “a right to combine accounts” (R Derham *The Law of Set-Off* 3 ed (2003) 645).

⁶⁸ See Derham *The Law of Set-Off* 645, 646; PR Wood *English and International Set-Off* (1989) 91, 93.

⁶⁹ See Derham *The Law of Set-Off* ch 15; Wood *English and International Set-Off* ch 3; EP Ellinger *Modern Banking Law* (1987) 139 sqq. It is sometimes argued that the right to combine accounts is not set-off, but merely an accounting matter (*Halesowen Presswork & Assemblies Ltd v Westminster Bank Ltd* [1971] 1 QB 46; Derham *The Law of Set-Off* 647-655; R Goode *Legal Problems of Credit and Security* 3 ed (2003) 255; Pichonnaz & Gullifer *Set-Off in Arbitration* 128). According to Wood *English and International Set-Off* 92, “current account set-off has often been treated as not being set-off at all”. In terms of this view, there is only one debt, and therefore the book-keeping entry which consolidates the two accounts does not constitute payment (Derham *The Law of Set-Off* 647).

⁷⁰ Wood *English and International Set-Off* 96; Ellinger *Modern Banking Law* 147.

⁷¹ *United Rentals Ltd v Clydesdale and North of Scotland Bank Ltd* 1963 S.L.T. (Sh. Ct.) 41; WW McBryde *The Law of Contract in Scotland* 3 ed (2007) 743 n 133.

of the Consumer Credit Act requires creditors to provide consumers with an adequate explanation of, inter alia,

“the features of the agreement which may operate in a manner which would have a significant adverse effect on the debtor in a way which the debtor is unlikely to foresee [and] the principal consequences for the debtor arising from a failure to make payments under the agreement at the times required by the agreement including legal proceedings and, where this is a possibility, repossession of the debtor's home”.⁷²

It could be argued that these provisions oblige creditors to inform debtors of the possibility of set-off when the credit agreement is concluded, but they do not prescribe any conditions for the exercise of such a right.

The Lending Code,⁷³ to which most banks in the United Kingdom subscribe,⁷⁴ contains several guidelines on the exercise of set-off by banks. In terms of that Code, banks are required to inform the client about the circumstances that will usually lead to the bank invoking its right to set-off.⁷⁵ This information must be conveyed at the time when the bank is considering or is likely to invoke set-off.⁷⁶ Banks are also required to use the information at their disposal to establish whether the client is experiencing financial difficulties, and to ensure that the client is left with sufficient funds to meet living expenses and priority debts.⁷⁷ Generally, banks are only allowed to recover the most recent missed payment by way of set-off, although in certain circumstances they can collect more.⁷⁸ Furthermore, banks are required to inform the client after set-off has been utilised for the first time.⁷⁹

The Financial Ombudsman has also issued some guidelines to banks.⁸⁰ In terms of these guidelines, banks are requested to inform the client that it has appropriated

⁷² Ss 55A(2)(c) and 55A(2)(d) of the Consumer Credit Act 1974.

⁷³ British Bankers' Association & The UK Cards Association “The Lending Code” (28-09-2015) *Lending Standards Board* <<http://www.lendingstandardsboard.org.uk/docs/lendingcoderevised0915.pdf>> (accessed 30-11-2015).

⁷⁴ See a list of subscribing banks at <http://www.lendingstandardsboard.org.uk/subscriberlist.php>.

⁷⁵ British Bankers' Association & The UK Cards Association “The Lending Code” *Lending Standards Board* para 195.

⁷⁶ Para 195.

⁷⁷ Para 196.

⁷⁸ Para 198.

⁷⁹ Para 199.

⁸⁰ Financial Ombudsman Service “Banking: Firms' Right of ‘Set Off’” (2004) 40 *Ombudsman News* 3-7 <<http://www.financial-ombudsman.org.uk/publications/ombudsman-news/40/40.pdf>> (accessed 30-11-2015); Financial Ombudsman Service “Recent Banking Complaints Involving ‘Set Off’” (2010) 84

money as soon as possible after a transfer is made⁸¹ and the duty of the bank to treat clients fairly is emphasised.⁸²

Clients are also protected against the possible adverse effects of set-off by inferring a tacit agreement between the bank and the client to exclude the operation of set-off. According to Wood, “[t]he implication that a loan account and a current account are to be kept separate will usually arise by reason of the fact that the client would otherwise have no security in drawing cheques if the loan account exceeds the credit balance”.⁸³ A similar agreement will be inferred where the bank is aware that an account is kept for a special purpose, for instance for payment of a specific creditor.⁸⁴

Generally a bank is not required to give notice to a client before effecting set-off.⁸⁵ However, it has sometimes been stated that notice might be a requirement,⁸⁶ and the position is not yet clear.⁸⁷ Notice might also be required based on the agreement between the parties, for instance where the bank decides to cancel an agreement not to combine the accounts.⁸⁸

Although the right of combination of accounts is normally exercised by a bank, Wood is of the opinion that it is also possible that the client may invoke the right and instruct the bank to treat two accounts as one.⁸⁹ Goode does not agree, and argues that the client only has the right to request the bank to transfer the credit balance from one

Ombudsman News 3-11 <<http://www.financial-ombudsman.org.uk/publications/ombudsman-news/84/84.pdf>> (accessed 30-11-2015).

⁸¹ Financial Ombudsman Service 2004 *Ombudsman News* 4.

⁸² Financial Ombudsman Service 2010 *Ombudsman News* 4.

⁸³ *English and International Set-Off* 688-689, with reference to *Bradford Old Bank Ltd v Sutcliffe* [1918] 2 K.B. 883. Also see Goode *Credit and Security* 257, who states that in the absence of such an inferred agreement, the customer could never safely draw a cheque if the balance of his current account does not sufficiently exceed that of his loan account.

⁸⁴ Wood *English and International Set-Off* 689; Ellinger *Modern Banking Law* 149-150.

⁸⁵ Ellinger *Modern Banking Law* 154.

⁸⁶ See for instance *National Westminster Bank Ltd v Halesowen Presswork and Assemblies Ltd* [1972] AC 785 810, where Lord Cross of Chelsea said that: “the bank would be obliged to honour cheques drawn up to the limit of the apparent credit balance before the company became aware that the bank was consolidating the accounts and so it might be said that notification to the customer was not a condition precedent to the exercise by the bank of its right of consolidation but only a measure of precaution which the bank might take to end its liability to honour cheques.”

⁸⁷ Ellinger *Modern Banking Law* 155.

⁸⁸ 154-155.

⁸⁹ Wood *English and International Set-Off* 96, with reference to *Libyan Arab Foreign Bank v Bankers Trust Company* [1987] 2 F.T.L.R. 509.

account to another, but that this does not amount to exercising a right to set-off.⁹⁰ Again the position is unclear, but it is recognised that set-off might in certain instances be required for protecting a consumer's rights.⁹¹

5 3 3 2 2 European Commission

Consumer credit in the European Union is regulated by Directive 2008/48/EC⁹² (the Consumer Credit Directive). It was adopted by the European Commission in 2008 and serves as a minimum standard with which the legislation of member states must comply. In terms of the Consumer Credit Directive, the right of credit providers to invoke set-off is not limited and again there are no provisions similar to sections 90 or 124 of the NCA.

The Consumer Credit Directive only refers to set-off in the context of protecting the consumer's right to rely on it. Despite objections by the banks,⁹³ it provides that where the creditor assigns his rights under a credit agreement, the consumer retains any rights he would have had against that creditor, including the right to rely on set-off.⁹⁴ Similarly, Directive 93/13/EEC on unfair terms⁹⁵ prevents a supplier from excluding a consumer's right to rely on set-off.⁹⁶

This does not mean that member states do not set their own restrictions for a bank's right to invoke set-off. In fact, in Europe "the view is widely held that set-off should not be allowed to deprive a person of claims (such as those for maintenance or wages) which provide him with a minimum level of subsistence".⁹⁷ For instance, in Austria this is done by protecting certain payments from any manner of attachment, including set-

⁹⁰ Goode *Credit and Security* 255.

⁹¹ Item 1 of Sch 2 of the Unfair Terms in Consumer Contracts Regulations 1999 contains a non-exhaustive list of terms which may be regarded as unfair, and includes a term "inappropriately excluding or limiting the legal rights of the consumer vis-à-vis the seller or supplier or another party in the event of total or partial non-performance or inadequate performance by the seller or supplier of any of the contractual obligations, including the option of offsetting a debt owed to the seller or supplier against any claim which the consumer may have against him".

⁹² Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on credit agreements for consumers and repealing Council Directive 87/102/EEC.

⁹³ RF Brennan "Consumer credit and the EEC" in RM Goode (ed) *Consumer Credit* (1978) 363 381.

⁹⁴ Art 17(1) of Directive 2008/48/EC.

⁹⁵ Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts.

⁹⁶ Art 3(3), read with Annex 1(b).

⁹⁷ Zimmermann *European Law of Set-Off* 57. This consideration is also reflected in the UK Lending Code, discussed above (see 5 3 3 2 1).

off. These include payments for social support received during maternity leave or money received for raising children.⁹⁸ France excludes set-off of amounts received as maintenance.⁹⁹ These exclusions are not limited to a certain type of debtor or creditor, but rather depend on the nature of the funds. Practically, this places an impossible burden on the bank, as it will require the bank to differentiate between amounts deposited in a bank account based on the source of such funds.¹⁰⁰

Certain exclusions and requirements are also established based on the nature of a contract of deposit (which includes the deposit of money with a bank).¹⁰¹ For instance, both the Swiss Code of Obligations¹⁰² and the French *Code Civil*¹⁰³ provide that the obligation to repay a deposit cannot be discharged by set-off, although this can be varied contractually.¹⁰⁴ German law, although containing no explicit limitations to the right to invoke set-off in order to protect consumers, will not allow set-off where it contravenes the purpose of the contract (for instance where that purpose is to ensure that the client has access to liquid funds) as this would be contrary to the principle of good faith in Article 242 of the German Civil Code.¹⁰⁵

5 3 3 2 3 New Zealand

In New Zealand, consumer protection in the context of credit agreements is regulated by the Credit Contracts and Consumer Finance Act 2003. Save to entrench a creditor's right to set off statutory damages and penalties payable against the indebtedness of the consumer,¹⁰⁶ no mention is made of set-off. However, the Act does provide that:

“A creditor may subsequently adjust debits or credits to a debtor's account and account balances so as to accurately reflect the legal obligations of the debtor and the creditor.”¹⁰⁷

⁹⁸ Ss 290 and 293 of the Enforcement Act; W Faber "Austria" in A C Ciacchi & S Weatherill *Regulating Unfair Banking Practices in Europe: The Case of Personal Suretyships* (2010) 45 49 n 29.

⁹⁹ Art 1293(3) *Code civil*.

¹⁰⁰ See Wood *English and International Set-Off* 680. He further states (in the context of English law) that because it is too onerous to expect banks to differentiate between funds received based on the source of such funds, money which would normally be protected against set-off, such as maintenance or public pension, would lose this character once it is paid into a general bank account, and would therefore be susceptible to set-off by the bank.

¹⁰¹ See Pichonnaz & Gullifer *Set-Off in Arbitration* 283-287 for a full discussion.

¹⁰² Art 125(1).

¹⁰³ Art 1293(2).

¹⁰⁴ Pichonnaz & Gullifer *Set-Off in Arbitration* 284.

¹⁰⁵ 284.

¹⁰⁶ S 24(1) of the Credit Contracts and Consumer Finance Act 2003.

¹⁰⁷ S 47(2) of the Credit Contracts and Consumer Finance Act 2003.

This provision is repeated verbatim in section 112(3) of the NCA. It is not clear whether this refers to merely adjusting the account balance where payment is received in respect of that account, or whether the bank is also thereby authorised to state the position after set-off has been effected by the bank. The contexts in which both these provisions appear support the former interpretation.

5 3 4 Conclusion

It has been seen that none of the factors considered above unequivocally point to a specific interpretation of sections 90(2)(n) and 124 of the NCA. Considerations regarding the spirit and purposes of the NCA are ambiguous at best: they support some restrictions to the credit providers' right to invoke set-off, but not as restrictive as those found in these sections (if interpreted in the manner advanced by the NCR).

The origin of sections 90(2)(n) and 124 of the NCA are also unclear. Neither the study of the policy documents prepared in the drafting of the NCA, nor the evaluation of the jurisdictions which influenced the drafting of the NCA explain where they came from. Searches in various jurisdictions on different keywords and phrases contained in these sections have also yielded no results. This leads to the conclusion that sections 90(2)(n) and 124 of the NCA have not been adopted from similar legislation in either the jurisdictions discussed above or other jurisdictions which the legislature might have considered.

However, this analysis reveals that it is recognised in most jurisdictions that some limits are required to protect consumers from the potentially harsh consequences of set-off, although there is not a uniform manner in which this is done. Yet, the protection rarely amounts to a complete exclusion of the right of a bank to rely on set-off by setting such stringent requirements for exercising this right (such as those found in section 124 of the NCA), that it may only be exercised in accordance with a contractual authorisation.

It is further evident that in most cases, it is felt that a consumer should not be deprived of his right to invoke set-off. This shows that set-off can also operate in favour of the consumer, and it should therefore not be viewed only as a mechanism to be used by the bank to the detriment of the consumer. It was also seen that allowing a bank to

invoke set-off within reasonable limits can in certain instances lead to a more favourable outcome for the consumer.¹⁰⁸

5 4 Other considerations which may influence the interpretation of sections 90 and 124 of the NCA

It remains to be considered whether any other provisions of the NCA will frustrate the interpretation of sections 90(2)(n) and 124 of the NCA favoured by the banks. Because banks, as credit providers who also take deposits, will be especially affected by sections 90(2)(n) and 124 of the NCA, the impact of the Code of Banking Practice on a bank's common-law right to set-off must also be considered.

5 4 1 The "plain language" requirements, disclosure requirements and reckless credit provisions contained in the NCA

Let us assume that the banks correctly maintain that sections 90 and 124 of the NCA only apply if the right to set-off is stipulated in the contract. The question then arises whether the failure to mention the bank's right to rely on set-off amounts to a contravention of section 64 of the NCA.¹⁰⁹ This section requires documents delivered to a consumer in terms of the NCA to be in plain and understandable language. Plain language is language that will enable the ordinary consumer with the average literary skills and minimal credit experience to understand the content, significance and import of the document, having regard to *inter alia* the context, comprehensiveness and consistency of the document.¹¹⁰ This includes the requirement that the language in the document should be of such a nature "that the consumer is not required to consult

¹⁰⁸ See ch 5 (5 3 2 2).

¹⁰⁹ Ss 64(1) and 64(2) of the NCA read as follows:

"Right to information in plain and understandable language.

(1) The producer of a document that is required to be delivered to a consumer in terms of this Act must provide that document—

(a) in the prescribed form, if any, for that document; or
(b) in plain language, if no form has been prescribed for that document.

(2) For the purposes of this Act, a document is in plain language if it is reasonable to conclude that an ordinary consumer of the class of persons for whom the document is intended, with average literacy skills and minimal credit experience, could be expected to understand the content, significance, and import of the document without undue effort, having regard to—

(a) the context, comprehensiveness and consistency of the document;
(b) the organisation, form and style of the document;
(c) the vocabulary, usage and sentence structure of the text; and
(d) the use of any illustrations, examples, headings, or other aids to reading and understanding."

¹¹⁰ S 64(2) of the NCA.

an external source to clarify or interpret any part of the document”.¹¹¹ In *Standard Bank of South Africa Ltd v Dlamini*¹¹² the court said that:

“purposively interpreted [sections 63 and 64 of the NCA] embody the right of the consumer to be informed by reasonable means of the material terms of the documents he signs [and means] the credit provider bears the onus to prove that it took reasonable measures to inform the consumer of the material terms of the agreement.”¹¹³

In the light of the fact that the ordinary consumer will not be aware of the bank’s right to apply set-off, it can be argued that the failure to make the consumer aware of this important consequence of concluding the credit agreement contradicts the purpose of the so-called plain-language requirement contained in section 64 of the NCA. However, the section specifically states that credit provider must ensure that “the *document* [is] in plain language”¹¹⁴ and it can be argued that the focus is on the language used in the text of the document, rather than what should be included in the document. It can thus be argued that the interpretation by the court in *Standard Bank v Dlamini*¹¹⁵ is more expansive than what the wording of the sections allow.¹¹⁶

To determine what information the credit provider should include in the document which constitutes the credit agreement, regard should be had to the disclosure requirements set by the NCA.¹¹⁷ The focus of the disclosure requirements is mostly on the cost of credit,¹¹⁸ and does not require a disclosure of the common-law rights enjoyed by the credit provider. Although it can be speculated that the legislature would have provided for the disclosure of the right to set-off if the issue had been brought to its attention during the process of drafting the NCA, as the Act stands non-disclosure of the right to set-off by a credit provider does not amount to a contravention of the NCA.

¹¹¹ Scholtz et al *National Credit Act* 6-8.

¹¹² 2013 1 SA 219 (KZD).

¹¹³ Para 48.

¹¹⁴ S 64(1) of the NCA (own emphasis).

¹¹⁵ 2013 1 SA 219 (KZD).

¹¹⁶ M Nortje “Informational Duties of Credit Providers and Mistake” 2014 *TSAR* 212 216-217.

¹¹⁷ Chapter 5 Part B of the NCA.

¹¹⁸ See ss 100 – 106 of the NCA. The need for proper disclosure of the cost of credit was also highlighted by the Technical Committee (Department of Trade and Industry “Credit Law Review August 2003: Summary of Findings of the Technical Committee” *National Credit Regulator* 12, 20).

It can further be argued, as contended by Nortje,¹¹⁹ that the duties of disclosure arise from the provisions of the NCA relating to reckless credit.¹²⁰ Section 81(2)(a) obliges a credit provider to take reasonable steps to assess the proposed consumer's

“general understanding and appreciation of the risks and costs of the proposed credit, and of the rights and obligations of a consumer under a credit agreement”.

If a credit provider fails to make the consumer aware of the possibility that set-off might be invoked, the credit provider may fall short of its duty in terms of this provision. This can lead to a court setting aside all or part of the agreement or suspending its force and effect.¹²¹ However, it seems unlikely that a credit agreement can be classified as reckless merely because the consumer was unaware of one of the credit provider's common-law rights.

5 4 2 The Code of Banking Practice

The last consideration, which is of relevance specifically for banks, is the provisions of the Code of Banking Practice¹²² (the Code). Most South African banks are also members of the Banking Association of South Africa,¹²³ and therefore subscribe to the Code. An amended Code was accepted by the Banking Association of South Africa pursuant to the commencement of the NCA.¹²⁴ Section 7.5 of this Code provides as follows:

“When you open an account, we will provide you with information that will include clear and prominent notice of any rights of set-off that we may claim over credit and debit balances in your different accounts.”¹²⁵

When you obtain credit from us, we may require your consent to set-off any outstanding amounts against funds available in other accounts you hold with us. Any such arrangement

¹¹⁹ Nortje 2014 *TSAR* 221-222.

¹²⁰ Specifically ss 80 and 81 of the NCA.

¹²¹ S 83(2) of the NCA.

¹²² The Banking Association of South Africa “Code of Banking Practice” (01-12-2012) *The Banking Association of South Africa* <<http://www.banking.org.za/docs/default-source/default-document-library/code-of-banking-practice-2012.pdf?sfvrsn=10>> (accessed 30-11-2015).

¹²³ See a list of member banks at <http://www.banking.org.za/about-us/member-banks>.

¹²⁴ The new Code was accepted in June 2011 and applied from 1 January 2012 (The Banking Association of South Africa “Code of Banking Practice” *The Banking Association of South Africa* 3, 37).

¹²⁵ A similar requirement can be found in s 7.1.5 of the Code, which obliges banks to advise the client regarding the right to invoke set-off at the time of opening the account.

will be concluded in terms of the requirements of the NCA, if the credit agreement is subject to the NCA.

We will inform you promptly after we have effected set-off in respect of any of your accounts. You will receive timely statements (if statements are generally produced on the relevant account), which will reflect the setoff position.

Prior to setting off your debit and credit balances, we may elect to place any of your funds on hold pending a discussion with you on any amount owed to us.”

These provisions, read with section 90(2)(n) of the NCA, create a difficult situation for a bank. In terms of the Code, a bank is required to inform the client of its right to invoke set-off when the client opens an account with the bank; this presumably means that a clause to that effect must be inserted in the credit agreement. However, if the bank inserts such a clause it will have to comply with the requirements of section 124 of the NCA. This means that instead of just informing the client in general that any account might be susceptible to set-off should the client be in default, a bank will now have to obtain the specific authorisation contemplated in clause 124.

The Code does not make it clear whether the bank must obtain consent before invoking set-off, merely stating that the bank *may* require the client's consent. It does provide that if such consent is required and the agreement is subject to the NCA, it will be obtained in conformance with the NCA. It is thus uncertain whether the Code still allows a bank to unilaterally rely on set-off, especially in light of the fact that the Ombudsman for Banking Services acknowledged that they cannot prevent the bank from invoking set-off¹²⁶ (although this statement was made before commencement of the new Code).

The requirement of informing the client after set-off was effected is not contained in the NCA, but is to be welcomed, inasmuch as the bank must not already in terms of the common law declare set-off (to the client) in order to effect it. It provides protection to the consumer, without detracting from a bank's security. It also does not place a too heavy administrative burden on a bank, while possibly preventing detriment to the

¹²⁶ Ombudsman for Banking Services “Consumer Information Note 5: Set-Off” *Ombudsman for Banking Services* 3.

client (such as the possibility of incurring the additional costs of a returned cheque or a declined debit order).¹²⁷

5 5 Suggestions for legislative reform

In the light of all the factors mentioned above, it seems as if the courts will probably favour the interpretation advanced by the banks regarding the meaning of section 90(2)(n) of the NCA. However, it is evident that the current provisions create uncertainty and should be amended to clarify the situation. Furthermore, if interpreted in accordance with the view of the banks, the illogical situation arises that non-disclosure of a right is a prerequisite to retaining that right. The outcome is also more detrimental for the consumer, since the credit provider will desist from inserting a clause in a credit agreement informing the consumer about the possibility of the credit provider invoking set-off.

However, even if the courts interpret section 90(2)(n) as not restricting a credit provider's common-law right to rely on set-off, this will provide little relief to a bank, who will be obliged to inform the client about the bank's right to invoke set-off in terms of the Code of Banking Practice. This means that a bank will in any event have to comply with the provisions of section 124 of the NCA. As argued above, this does not necessarily lead to the best result for either the bank or the consumer.¹²⁸

It is submitted that the current requirements set by the NCA for enforcement of the bank's right to set-off are too restrictive. By insisting on a section 124 authorisation for any appropriation of funds from a client's account, the legislature is throwing the proverbial baby out with the bathwater instead of finding a balance where set-off can benefit both the bank and the client.

Undoubtedly, the bank's right to invoke set-off without notice to the consumer can create difficulty for the consumer,¹²⁹ and some form of regulation is required. However, it can be argued that denying banks their common-law right to set-off will have an adverse effect both on the accessibility and the cost of credit, as it would compel banks

¹²⁷ See Sepinuck 1988 *Wm. & Mary Law Review* 65, where he expressed the opinion that American states that do not require such notice are delinquent, since it "requires minimal effort, can produce no harm and may actually serve a useful purpose."

¹²⁸ See 5 3 2 2 above.

¹²⁹ Pretorius 2008 *JBL* 4.

to require some other form of security and to raise the interest rate to compensate for the increased risk.

Ideally a solution should be found which provides a better balance between the interests of the credit provider and that of the consumer. It was confirmed by the Supreme Court of Appeal that

“[t]he interpretation of the NCA calls for a careful balancing of the competing interests sought to be protected, and not for a consideration of only the interests of either the consumer or the credit provider.”¹³⁰

In line with the purpose of the NCA, and taking into account the approach followed in other jurisdictions, it is submitted that a sounder solution would be a combination of the approaches recommended by the Ombudsman for Banking Services, the Code of Banking Practice and the United Kingdom’s Lending Code.

It is therefore suggested that the following conditions should be set for the exercise of a credit provider’s common-law right to invoke set-off: (i) the client must be informed of the credit provider’s right to rely on set-off when an account is opened or a loan granted to the client; (ii) the credit provider should only be able to recover the most recent missed payment, except in exceptional circumstances (for instance where the client has an account which is mostly dormant with insufficient funds to cover the debt, the client has defaulted more than once before despite the bank making several attempts at contacting the client, and a large amount is suddenly deposited in the client’s account); and (iii) the credit provider must inform the client promptly after it has exercised its right to set-off.

The first condition is acknowledged by the South African Banking Code, which requires banks to inform a client of the possibility of set-off when an account is opened.¹³¹ This will also be in line with the aim of the NCA to inform the consumer as fully as possible of his rights and obligations.

The second condition is similar to the approach recommended in the Lending Code, which suggests that banks should only rely on set-off in respect of the most recent

¹³⁰ *Nedbank Ltd v National Credit Regulator* 2011 3 SA 581 (SCA) para 2. Also see s 3(d) of the NCA.

¹³¹ Ss 7.1.5 and 7.5.

missed payment.¹³² It is also in accordance with the approach recommended by the Ombudsman of Banking Services, who has requested banks to apply set-off as fairly as possible. It is further recommended by the Ombudsman that banks should not attach a client's entire salary, but limit it to a reasonable portion, in order to prevent a snowball effect where clients are unable to service their other debts.¹³³

Lastly, the South African Code also compels a bank to inform the client as soon as possible after set-off has been effected. The manner in which this must be done is not specified; presumably a text message or e-mail would suffice. This prevents the client from incurring additional costs due to debit orders or cheques that are declined or returned. It also allows the client to contact the bank as soon as possible if he is of the view that he has been treated fairly unfairly or can raise a defence against the bank's claim. Although a declaration of set-off may already be required in terms the common law (depending on which approach is followed), inserting this condition will provide protection even if the automatic approach to set-off is adhered to and will further prevent a bank from contractually excluding the requirement of notice.¹³⁴

Achieving a proper balance between the respective rights and responsibilities of credit providers and consumers is not only an objective of the NCA,¹³⁵ but it also benefits both the consumer and the credit provider. This balance cannot be achieved without an in-depth consideration of the effect of a provision included in the NCA on the respective role players. It is submitted that this evaluation was lacking in respect of sections 90(2)(n) and 124 of the NCA, and the legislature would do well to reconsider the requirements set for the exercise of a credit provider's right to set-off.

¹³² See 5 3 3 2 1 above.

¹³³ Ombudsman for Banking Services "Consumer Information Note 5: Set-Off" *Ombudsman for Banking Services* 3.

¹³⁴ Also see ch 6 (6 3).

¹³⁵ S 3(d) of the NCA.

CHAPTER 6: CONCLUSION

6 1 Introduction

No uniform answer exists to the question of how set-off operates in the South African law: it is held either to operate automatically as soon as its requirements are met or to require a declaration by one of the parties, in which case it operates with retrospective effect.¹ This dissertation considered the uncertainty and problems surrounding these two opposing approaches to the operation of set-off. After tracing the historical development of the principles of set-off in order to determine the origin of these approaches,² their application in modern law, both in South Africa and elsewhere, was considered.³ It became apparent that neither of the approaches to set-off followed in South African law provides an adequate explanation of the way in which set-off is applied in practice and consequently both are subject to a range of exceptions.

An analysis of international developments showed that

“there is general convergence – although still ongoing – towards a regime of set-off by notice, even in those systems based on automatic set-off, with good reasons to provide for a more prospective effect.”⁴

The following questions are implicit in this statement and also central to this thesis: (i) what would the reasons be for such a general trend, even in systems which have traditionally recognised the automatic operation of set-off, towards the view that set-off can only be effected by means of a notice;⁵ and (ii) what would the justification be for ascribing a prospective effect to this notice?⁶

These questions were considered specifically in the South African context, and the aim was to evaluate whether, in the light of the problems experienced with the current approaches to set-off and international developments in this regard, a need exists for legal reform in South Africa. This evaluation included an examination of the applicable principles where a party's right to invoke set-off is excluded based either on an

¹ See ch 3.

² See ch 2.

³ See ch 3.

⁴ P Pichonnaz & L Gullifer *Set-Off in Arbitration and Commercial Transactions* (2014) 170.

⁵ See ch 3.

⁶ See ch 3.

agreement between parties or the ostensible intention of one of the parties not to invoke set-off.⁷

Another aspect which was considered is the impact of current consumer legislation, and specifically sections 90(2)(n) and 124 of the National Credit Act 34 of 2005 (NCA), on the right of a credit provider to invoke set-off. This discussion included a determination of the extent to which legislative measures are desirable in order to protect consumers from the consequences of set-off.⁸

The conclusions arrived at during the course of the study, both with regards to the operation of set-off and the impact of the NCA, are briefly outlined below. They are followed by suggestions for possible reform of the South African approach to the operation of set-off.

6 2 Overview of findings

6 2 1 Findings regarding the operation of set-off

Set-off has evolved from a fragmented and purely procedural mechanism in classical Roman law to the extra-judicial process found in modern law.⁹ The decrees of Justinian, which describe set-off as an extinction of debts that takes place *ipso iure*, were an important influence on this development.¹⁰ With this, the Emperor generalised the approach to set-off, and made its operation independent of the discretion of the judge. However, it was not clear exactly what Justinian meant by the phrase “*ipso iure*”, and attempts to interpret these decrees have led to generations of jurists focusing on whether set-off operates automatically, and thus irrespective of the will of the parties.

Uncertainty in this regard, together with the practical difficulties experienced in the application of the automatic approach, led to the development of a second view, namely that a declaration is required to effect set-off. Attempts to reconcile this approach with the automatic approach resulted in the notion that this declaration, although required for the operation of set-off, has a retrospective effect. In terms of

⁷ See ch 4.

⁸ See ch 5.

⁹ See ch 2.

¹⁰ *Inst* IV 6 30; *C* 4 31 14.

both approaches it was thus accepted that the effect of set-off dates back to the moment its requirements are first met.¹¹

These developments led to the two opposing views which enjoy support in current South African law: set-off is held either to operate automatically (although it has to be pleaded in court),¹² or it has to be declared by one of the parties, whereupon it operates retrospectively at the moment when the debts first became susceptible to set-off.¹³ It has been shown that both these approaches are based on a possible misinterpretation of Justinian's decrees,¹⁴ or what Pichonnaz and Gullifer refer to as a "creative interpretation" of Roman law sources.¹⁵ More importantly, the debate regarding the operation of set-off in jurisdictions that derive their rules relating to set-off from Roman law has focused on the interpretation of historical sources, rather than on adopting a pragmatic approach to determine which approach to set-off best supports its role and function in modern society.¹⁶ This is also true in the South African context. It can thus be argued that legal development has suffered as a result of historical uncertainties and that "die Suid-Afrikaanse reg eintlik in 'n groot mate by Martinus vasgehaak het."¹⁷

This lack of a practical dimension to the debate in South African law therefore directed the focus in chapter 3 on the effect of the two possible approaches to set-off on everyday commercial transactions. It also motivated the discussion in chapter 4 on the exclusion of the right to set-off, either by means of an agreement between the parties¹⁸ or where one of the parties has waived the right to invoke set-off.¹⁹

It has been shown that a strict application of the *ipso iure* approach (which is favoured in the majority of cases) is largely irreconcilable with practical reality. The biggest objection to this approach is that it affords insufficient recognition to the autonomy of contracting parties. This incompatibility with the principle of freedom of contract leads

¹¹ P Pichonnaz "The Retroactive Effect of Set-Off (*Compensatio*): A Journey through Roman Law to the New Dutch Civil Code" 2000 *TR* 541 563; Pichonnaz & Gullifer *Set-Off in Arbitration* 165.

¹² See ch 3 (3 4 1 n 86).

¹³ See ch 3 (3 4 1 n 95).

¹⁴ Ch 2 (2 4 4). Also see Pichonnaz 2000 *TR* 541-546.

¹⁵ Pichonnaz & Gullifer *Set-Off in Arbitration* 140.

¹⁶ See n 27 below.

¹⁷ "The South African law largely remained stuck at Martinus" (own translation) – S Scott "Skuldvergelyking – Toe (ex tunc) en Nou (ex nunc)" 2006 *TSAR* 595 601.

¹⁸ See ch 4 (4 2 2).

¹⁹ See ch 4 (4 3).

to various inconsistencies in the practical application of the automatic approach. This is illustrated by the fact that parties are still allowed to exclude the operation of set-off contractually, even after the debts become susceptible to set-off,²⁰ and by allowing a party to waive his right to invoke set-off, even though the debts were already extinguished due to the automatic operation of set-off.²¹ Even in cases where payment has been made after the debt was susceptible to set-off, some authors still allow the debtor to disregard the operation of set-off and reclaim the original debt.²²

A further problem with the *ipso iure* construction is the fact that the debts are regarded as extinguished from the moment the requirements for set-off are met. However, if an action is instituted in respect of one of the debts and the defendant fails to raise the defence of set-off, it cannot be taken into account.²³ This again demonstrates the divergence between theory and practice, because it reveals that a court will give judgement on a debt which the law regards as already settled.

The minority view, namely that set-off depends on a declaration, addresses the problem of autonomy. It recognises the fact that set-off depends on the will of the parties. However, the retrospective effect attributed to the declaration of set-off renders the practical application of this approach similarly incapable of regulating modern commercial relationships.²⁴ The practical problems which are caused by attributing a retrospective effect to the declaration of set-off are particularly apparent when the following two consequences are considered: (i) any interest charged, for instance by a bank on two separate accounts, has to be adjusted retrospectively;²⁵ and (ii) a party's default, for instance in the form of non-payment of the rent in terms of a lease agreement, will be cured retrospectively.²⁶ Like the *ipso iure* view, it is clear that the retrospective approach

²⁰ See ch 4 (4 2 2).

²¹ See ch 4 (4 3).

²² See ch 3 (3 4 2 4 n 142).

²³ RH Christie & GB Bradfield *Christie's The Law of Contract in South Africa* 6 ed (2011) 495.

²⁴ See ch 3 (3 6 and 3 8).

²⁵ See ch 3 (3 4 2 5).

²⁶ See ch 3 (3 4 2 6); *Southern Cape Liquors (Pty) Ltd v Delipcus Beleggings BK* 1998 4 SA 494 (C).

“is not based on convincing rational arguments but rather constitutes an unreflected continuation of a thinking pattern... based upon Justinian’s obscure pronouncements on the *ipso iure* effect of set-off.”²⁷

It is evident that both approaches to set-off currently adopted in South Africa are unsuitable to govern modern business relationships. A reconsideration is therefore required of the manner in which set-off is applied, taking into account its role and function in modern society.

Such a reconsideration is reflected in the drafting process of the PICC and the PECL.²⁸ In formulating the principles applicable to set-off, the respective committees not only considered the historical development of set-off, but also (and perhaps more importantly) evaluated the practical merits of the different approaches. Pragmatic considerations led them to conclude that although most civil law jurisdictions follow either the automatic or retrospective approach, neither approach offers an ideal solution. Therefore, both committees decided that it was necessary to deviate from these approaches and adopt an approach in terms of which set-off operates prospectively upon it being declared by either party.²⁹

This process and eventual conclusion can be very instructive when evaluating the South African approach.³⁰ However, in order to determine whether the proposition that set-off should operate prospectively from the moment that a notice is given is sound, it is necessary to assess the suggested approach by considering its practical

²⁷ O Lando, H Beale, A Prüm & R Zimmermann (eds) *The Principles of European Contract Law: Part III* (2003) 153-154 n 2.

²⁸ See specifically P Pichonnaz “Set-Off” in S Vogenauer (ed) *Commentary on the UNIDROIT Principles of International Commercial Contracts (PICC)* 2 ed (2005) 1033; P Pichonnaz “Set-Off *Compensatio*: From Diversity to Unity – Comments on the Principles of European Contract Law Part Three” in A Vaquer (ed) *The Principles of European Contract Law Part III* (2005) 281; Lando et al *European Contract Law*; R Zimmermann *Comparative Foundations of the European Law of Set-Off and Prescription* (2002); R Zimmermann “The UNIDROIT Principles of International Commercial Contracts 2004 in Comparative Perspective” 2006 *Tul Eur & Civ LF* 1; C Jauffret-Spinosi “UNIDROIT 2000 Study L – Doc 62 bis: Position Paper” (2000) *UNIDROIT* <<http://www.unidroit.org/english/documents/2000/study50/s-50-062bis-e.pdf>> (accessed 30-11-2015); C Jauffret-Spinosi “UNIDROIT 2001 Study L – Doc 71: Draft chapter” (2001) *UNIDROIT* <<http://www.unidroit.org/english/documents/2001/study50/s-50-071-e.pdf>> (accessed 30-11-2015).

²⁹ Arts 13:104 and 13:106 PECL; Arts 8.3 and 8.5 PICC.

³⁰ See also Scott 2006 *TSAR* 595, where she argues that as a part of the world community, South Africa should take note of international developments.

consequences,³¹ as well as the effect it will have on other legal phenomena such as waiver and estoppel.

6 2 2 Findings regarding the National Credit Act

As mentioned above, this dissertation also considered the impact of the NCA on the right of a credit provider to invoke set-off. It has been shown that, whether intentionally or not, sections 90(2)(n) and 124 of the NCA limit the right of a credit provider to insert a provision in a credit agreement which provides for set-off.³² Nevertheless, it is unlikely that these sections will be interpreted in a manner that also affects the common-law right of credit providers to rely on set-off. However, if they are read together with the South African Code, these provisions leave little scope for a bank to rely on set-off.³³ The Code obliges a bank to inform a client that it might invoke set-off, presumably by inserting such a clause in a credit agreement. This, in turn, means that the clause authorising set-off will have to comply with the requirements contained in section 124 of the NCA. Therefore, in order to appropriate money from an account of the client to reduce or settle an obligation of that client, the bank will have to obtain the authorisation contemplated in section 124 of the NCA, and will only be allowed to appropriate funds in accordance with that authorisation.

A study of sections 90(2)(n) and 124 of the NCA reveals not only that the ambit of these provisions is uncertain, but also that their application leads to an illogical situation where a credit provider has to refrain from stipulating a common-law right in a credit agreement in order to retain that right.³⁴ Furthermore, while certain limitations on the right to invoke set-off are justified,³⁵ and recognised in most jurisdictions,³⁶ prohibiting set-off by banks in its entirety is not beneficial either to banks or their clients because it could have a negative impact on both access to credit and the cost of credit.³⁷ These consequences are clearly not in line with the spirit of purpose of the NCA, and

³¹ Also see ch 3 (3 8), where the practical consequences of the prospective approach are discussed.

³² See ch 5.

³³ See ch 5 (5 4 2).

³⁴ See ch 5 (5 2 4).

³⁵ See the reasons given at ch 5 (5 3 2 1).

³⁶ See ch 5 (5 3 3).

³⁷ See ch 5 (5 3 2 2).

undoubtedly these sections have to be revised to clarify and improve the protection granted by them.

6 3 **Suggestions for reform**

If set-off is effected by a notice which operates *ex nunc*, the consequences will be similar to payment being made at that moment.³⁸ In other words, the debt is settled or reduced from the moment notice is given and interest will stop running. A declaration of set-off will not result in the breach of contract caused by late payment being cured retrospectively. The creditor will therefore still be allowed to rely on any remedies based on the debtor's late payment, such as invoking an acceleration clause in a loan agreement or evicting a lessee. Not only does this solve the practical problems experienced with the application of both the *ipso iure* and retrospective approaches, but it also enhances legal certainty.

Most of the problems faced by the *ipso iure* construction in respect of the exclusion of the right to invoke set-off are also resolved if a declaration is required to effect set-off. These are primarily (i) the problematic notion of allowing the parties to exclude or waive the operation of set-off, even though set-off supposedly operates independently of the wills of the parties; and (ii) the problems which arise where the operation of set-off is excluded or waived after the debt has already been extinguished by the automatic operation of set-off. Requiring a declaration for set-off to operate clearly recognises the autonomy of the parties, and there is no difficulty with the parties agreeing to exclude set-off or one party waiving his right to give notice of it. The problem of this agreement being concluded or waiver taking place after set-off has taken effect will rarely arise, because a declaration is required for set-off to become effective, and it is unlikely that the exclusion of set-off will happen after notice of it has already been given.³⁹

Admittedly, it does not make a difference in this regard whether the declaration has a prospective or retrospective effect. In terms of either alternative, set-off cannot operate before notice of set-off is given. However, attributing an *ex nunc* rather than *ex tunc* effect to the declaration may make a difference with regards to the question whether a

³⁸ Pichonnaz "Compensatio" in *Principles of European Contract Law* 297; Pichonnaz & Gullifer *Set-Off in Arbitration* 184-185. Also see ch 3 (3 7) for a discussion of these consequences.

³⁹ See ch 4 (4 2 2 1 and 4 3 1).

bank is deemed to waive its right to set-off, or can be estopped from invoking set-off, based on the fact that the bank charges interest separately on two accounts of the client. In this regard, it will be recalled that it may be argued that sending a statement which indicates that the bank charges or pays interest separately on two accounts of a client, the one standing to his debit and the other to his credit, suggests that the bank does not intend to rely on set-off.⁴⁰ This argument is more persuasive where set-off occurs automatically, because in that case the operation of set-off would mean there is only ever one debt. In other words, by charging interest separately on the two accounts, the bank is acting in a manner which contradicts the automatic operation of set-off. The client could therefore argue that the bank indicated its intention to waive its right to rely on set-off.

A similar argument can be advanced in terms of the retrospective approach: a reliance on set-off will result in interest having to be adjusted retrospectively, therefore charging interest separately on the two debts is also not consistent with the intention to invoke set-off. However, if set-off operates prospectively from the moment it is declared, it means that until such time as a declaration is made, there are two debts. Therefore, treating the debts as separate and charging two interest rates before notice of set-off is given does not contradict the effect of set-off, and cannot necessarily be taken as an indication that the bank will not rely on set-off. This result is preferable, as standard banking practices should not prevent the bank from relying on its right to invoke set-off.

Three possible complications may arise if a declaration of set-off is attributed an *ex nunc* rather than *ex tunc* effect. The first scenario is in the case of cession, where the requirements for set-off are met before the debt is ceded, but set-off is only declared thereafter. Instead of set-off operating automatically or taking effect retrospectively before the cession,⁴¹ the prospective effect of set-off would mean that it cannot be relied on after the debt has been ceded. The second scenario is where one of the parties becomes insolvent after the debts became susceptible to set-off, but before

⁴⁰ See ch 4 (4 3 3 1).

⁴¹ See ch 3 (3 4 2 2).

set-off was declared. Once again, the *ex nunc* approach will exclude the possibility of set-off taking effect before the insolvency of the party.⁴²

In these cases, it must be examined whether there are policy considerations which suggest that set-off should be allowed, despite the fact that notice of set-off is only given after the requirements for set-off are no longer met. It has been shown that in the case of cession, there are in any event two qualifications arising from this area of the law which offer protection to the debtor: he will be allowed to enjoy the benefit of cession where he in good faith attempts to set the debt off before becoming aware of the cession; or where the cession is made *mala fide*.⁴³ It is doubtful whether there are additional policy considerations justifying even greater protection in the event that a debt capable of set-off is ceded and the debtor, due to the prospective effect of set-off, is no longer able to rely on its operation.

In the case of insolvency, there are indeed policy considerations which might play a role in determining the operation of set-off. On the one hand, there is the notion that it might be unfair to expect a debtor to pay his entire debt, but only receive a part of the debt owed to him by the creditor.⁴⁴ For example, A and B are mutually indebted for the amount of R100, and B is declared insolvent before notice of set-off is given. If A is not allowed to rely on set-off, he would have to pay R100 to B's estate, but would only receive a dividend, for instance R80, of the debt owed to him, which may seem unfair towards A. On the other hand, there is the idea that all creditors should be treated equally upon insolvency.⁴⁵ The alternative to the previous example is thus that A is allowed to rely on set-off, which will in effect enable him to enforce the entire debt owed by B. This places him in a better position than another creditor of B who will only receive 80 cents in the rand instead of his full claim. If the prospective approach to set-off is followed, it would prevent a creditor of an insolvent from relying on set-off after *concurso creditorum*, since no action by creditors of the estate which will prejudice the rights of other creditors are allowed after that moment⁴⁶ and set-off would

⁴² Both these scenarios have been discussed in some detail in ch 3 (3 8).

⁴³ See ch 3 (3 8).

⁴⁴ This consideration was possibly also recognised in classic Roman law – see ch 2 (2 2 2 2). Also see R Goode *Legal Problems of Credit and Security* 3 ed (2003) 238.

⁴⁵ R Derham *The Law of Set-Off* 3 ed (2003) 245.

⁴⁶ RD Sharrock "Insolvency" in WA Joubert & JA Faris (eds) *The Law of South Africa* 11 2 ed (2008) para 199.

not be deemed to have occurred before insolvency. The result would therefore be similar to the first scenario mentioned above. If it is found in terms of policy considerations within the law of insolvency that the first consideration, namely the unfairness towards A, carries more weight than the latter, namely the equal treatment of creditors, provision can be made in existing insolvency laws to provide for a form of automatic set-off upon insolvency.⁴⁷

It is thus clear that the two situations which may require special treatment if the prospective approach to set-off is followed, are in any event subject to the specific rules applicable in those contexts. Therefore, where a deviation from the normal consequences of set-off is required based on policy considerations, it can easily be provided for in the rules dealing with cession and insolvency respectively.

The third and final possible objection to the prospective approach may be that it offers insufficient protection to a debtor who is unaware of the requirement of notice and who believes, in good faith, that his debts are settled by way of set-off. The possible flaws in this argument have been discussed in some detail in a previous chapter.⁴⁸ However, it should be mentioned here that this unintended adverse consequence can be mitigated by not making the declaration subject to strict formal requirements. If an informal, extrajudicial, unilateral notice, which may also be given orally, suffices to effect set-off, this problem would arise much less often. It is only in rare circumstances that a creditor will not make at least one demand in order to place the debtor in *mora*, and it is submitted that it is not unreasonable to expect that a debtor in those circumstances will indicate to the creditor that he regards the debt as settled by way of set-off. Furthermore, it is accepted in our law that in certain circumstances ignorance of the law is no excuse,⁴⁹ and it has been generally stated with regards to the maxim *ignorantia iuris neminem excusat* that

“it can be expected of a person who, in a modern State, wherein many facets of the acts and omissions of the legal subject are controlled by legal provisions, involves himself in a

⁴⁷ See the criticism against this function of set-off in ch 1 (1 2 2 n 45).

⁴⁸ See ch 3 (3 6). Also see Pichonnaz 2000 *TR* 560-561.

⁴⁹ *Kyriacou v Minister of Safety and Security* 1999 3 SA 278 (O) 290; *Ghandi Square Property Holdings (Pty) Ltd v Pension Fund Adjudicator* 2014 JDR 0183 (GNP) 14.

particular sphere, that he should keep himself informed of the legal provisions which are applicable to that particular sphere”.⁵⁰

It can thus be seen that the prospective approach offers a solution which, amongst other benefits, does not require

“a set of rules that is (i) based on a somewhat artificial fiction (both obligations ‘must be taken to have been discharged at the moment’ [that they are first susceptible to set-off]) and therefore difficult to explain doctrinally, (ii) detrimental to legal certainty, [and] (iii) not practicable without recognizing a number of exceptions”.⁵¹

With regards to consumer legislation restricting the right of a credit provider to invoke set-off, is preferable to find a more balanced solution than the one currently offered by the NCA. An ideal solution should offer the client sufficient protection without completely removing the security and convenience surrounding a bank’s right to invoke set-off. In this regard, the suggestion was made that the following conditions should be set for a credit provider to exercise its right to set-off: (i) the client must be informed of the credit provider’s right of set-off when concluding an agreement with the credit provider; (ii) only a reasonable amount should be appropriated by the credit provider, in most cases only the amount of the most recent missed payment; and (iii) the client must be informed as soon as possible after the credit provider has used its right to set-off.⁵²

The last requirement might seem unnecessary if the prospective approach to set-off is accepted, because the bank would in any event have to give notice to the client in order to effect set-off. However, since the requirements for set-off can be amended contractually,⁵³ legislation preventing the bank from contractually excluding the requirement of notice is advisable.

A further suggestion, should the prospective approach be followed, would be for the legislature to provide that a client cannot be in default while the bank is able to recover arrear payments by way of set-off. In the absence of such a provision, it would mean that despite the client having sufficient funds in one account to cover a loan payment

⁵⁰ *S v De Blom* 1977 3 SA 513 (A) 514; *Ghandi Square Property Holdings (Pty) Ltd v Pension Fund Adjudicator* 2014 JDR 0183 (GNP) 14. However, this maxim is applied in a nuanced manner – see *Willis Faber Enthoven (Pty) Ltd v Receiver of Revenue* 1992 4 SA 202 (A) 223.

⁵¹ Zimmermann *European Law of Set-Off* 42-43.

⁵² See ch 5 (5 5).

⁵³ See ch 4 (4 2 3).

which is due, the bank could decide not to invoke set-off and act on the client's breach. Unlike in the case of either the automatic or retrospective approach, the client cannot cure his breach by subsequently invoking set-off. If the legislature provides for this form of protection, set-off operates not only as a security measure for the bank, but also protects the client against the consequences of breach (such as the bank invoking an acceleration clause) as long as there are sufficient funds in his accounts to cover payments which are due and payable.

6 4 Concluding remarks

A study of the South African approach to set-off, and the lack of development based on pragmatic or legal comparative grounds, proves the statement by Hutchison and others that:

“Old habits die hard, and nowhere more so than in a precedent-bound system of law.”⁵⁴

Despite compelling reasons for reconsidering our approach to set-off, this has received little judicial attention. Failure to take note of international legal developments in this regard means that we remain constrained by a system which is out of touch with commercial reality and which has to recognise a range of exceptions in order to accommodate important principles like autonomy and contractual freedom. There is little justification for this, since our approach to set-off is in any event a matter of debate and thus far from settled.⁵⁵ In this thesis it has been suggested that the solution is for South African law to move towards an approach which has not only gained international recognition, but which also offers a much more consistent and satisfactory solution to the questions of how and when set-off should operate.

The question which naturally arises is how such reform can be achieved. Two possibilities present themselves, namely judicial development of the common law, or statutory reform. The latter is perhaps not the most suitable for an essentially doctrinal issue such as the nature of set-off. Furthermore, including provisions regarding set-off in existing legislation, for instance the NCA, will only affect its operation in

⁵⁴ D Hutchison “Forms of Breach” in D Hutchison & C-J Pretorius (eds) *The Law of Contract in South Africa* 2 ed (2012) 277 299.

⁵⁵ Scott 2006 TSAR 601.

transactions subject to that Act. It is therefore suggested that we rather look to the courts for reform of the common law relating to set-off.

While such a proposal may indeed appear far-reaching, it is certainly not without precedent. As Innes CJ acknowledged in an oft-repeated *dictum*:

“There come times in the growth of every living system of law when old practice and ancient formulae must be modified in order to keep in touch with the expansion of legal ideas, and to keep pace with the requirements of changing conditions.”⁵⁶

In *Pearl Assurance Co v Union Government*⁵⁷ it was also confirmed that

“[Roman-Dutch] law is a virile living system of law, ever seeking, as every such system must, to adapt itself consistently with its inherent basic principles to deal effectively with the increasing complexities of modern organised society.”⁵⁸

Ultimately, courts are entitled to resort to their inherent power to develop the common law in order to serve the interests of justice.⁵⁹ This power is confirmed in section 173 of the Constitution of the Republic of South Africa, 1996 (the Constitution), and the Supreme Court of Appeal has stated that

“without abandoning our legal heritage, the courts can and should examine how developed legal systems cope with common problems. By appropriate application of the knowledge thus derived, a modification of our existing law may better serve the interests of justice when the existing law is uncertain or does not adequately serve modern demands on it.”⁶⁰

In the light of the problems surrounding the current operation of set-off in South African law, and taking into account international developments, it is submitted that this is indeed an instance where the court should exercise its power to develop the common law in order to ensure that it meets modern demands. This is strengthened by the fact

⁵⁶ *Blower v Van Noorden* 1909 TS 890 905. This was confirmed inter alia in *Mineworkers Investment Co (Pty) Ltd v Modibane* 2002 6 SA 512 (W) para 28; *Janse Van Rensburg v Grieve Trust* CC 2000 1 SA 315 (C) 324; *Ongevallekommissaris v Santam Bpk* 1999 1 SA 251 (SCA) 259; *Willis Faber Enthoven (Pty) Ltd v Receiver of Revenue* 1992 4 SA 202 (A) 220; *Eerste Nasionale Bank van Suidelike Afrika Bpk v Saayman* NO 1997 4 SA 302 (SCA) 320; *Kommissaris Van Binnelandse Inkomste v Willers* 1994 3 SA 283 (A) 332-333.

⁵⁷ 1934 AD 560.

⁵⁸ 563. This was confirmed inter alia in *Mineworkers Investment Co (Pty) Ltd v Modibane* 2002 6 SA 512 (W) para 28; *Janse Van Rensburg v Grieve Trust* CC 2000 1 SA 315 (C) 324; *Willis Faber Enthoven (Pty) Ltd v Receiver of Revenue* 1992 4 SA 202 (A) 220; *Kommissaris Van Binnelandse Inkomste v Willers* 1994 3 SA 283 (A) 332-333.

⁵⁹ *Linvestment CC v Hammersley* 2008 3 SA 283 (SCA) para 25.

⁶⁰ Para 25.

that historical sources are inconclusive and there is thus scope for their re-interpretation.⁶¹

Courts are further obliged to promote the spirit, purport and objects of the Bill of Rights when developing the common law.⁶² In this regard, section 10 of the Bill of Rights, which grants everyone the right to dignity, is of particular relevance in the context of set-off.⁶³ In *Barkhuizen v Napier*⁶⁴ the Constitutional Court opined that

“[s]elf-autonomy, or the ability to regulate one’s own affairs ... is the very essence of freedom and a vital part of dignity.”⁶⁵

It is submitted that the automatic approach to set-off, in terms of which the claims of the parties are extinguished based on a rule of law, rather than the wishes of the parties, undermines the parties’ ability to regulate their own affairs. It thus potentially undermines the principle of self-autonomy and limits the parties’ right to dignity, leaving scope for judicial development of the common law relating to set-off in terms of section 39(2) of the Constitution.

There is little doubt that the current law regarding the operation of set-off is both uncertain and unable to cater for modern commercial relationships. Not only is there no uniform agreement on the manner in which set-off operates, but neither of the accepted approaches offer a solution which is consistent with the demands of practice. As previously argued,⁶⁶ there is little justification for sacrificing legal certainty to maintain a *status quo* which is based on questionable historical foundations and, more importantly, is clearly unsatisfactory. It is thus argued that South African courts should take note of international developments regarding the operation of set-off and opt for

⁶¹ See ch 2 (2 4 4) and ch 3 (3 1 n 1). Also see Pichonnaz 2000 *TR* 541-546.

⁶² S 39(2) of the Constitution.

⁶³ Another fundamental right which may be relevant is s 25(1) of the Bill of Rights, which grants everyone the right not to be arbitrarily deprived of his property. It was confirmed in *National Credit Regulator v Opperman* 2013 2 SA 1 (CC) para 63 that intangible property, such as the right to restitution of money paid, falls within the definition of property in the context of s 25(1) of the Constitution. On the question of what constitutes a deprivation, see *Offit Enterprises (Pty) Ltd v Coega Development Corporation (Pty) Ltd* 2011 1 SA 293 (CC) para 37-39; *National Credit Regulator v Opperman* 2013 2 SA 1 (CC) para 66; *Cool Ideas 1186 CC v Hubbard* 2014 4 SA 474 (CC) para 38. However, this deprivation will in all likelihood not be arbitrary (see *First National Bank of SA Ltd t/a Wesbank v Commissioner, South African Revenue Service*; *First National Bank of SA Ltd t/a Wesbank v Minister of Finance* 2002 4 SA 768 (CC) para 100) and the right to dignity therefore offers a more convincing basis for the judicial development of the common law relating to set-off.

⁶⁴ 2007 5 SA 323 (CC).

⁶⁵ Para 57.

⁶⁶ See ch 3 (3 8).

a solution which is more in line with modern commercial reality. Developing an approach in terms of which set-off operates prospectively upon notice being given will reduce the divergence which currently exists between legal and practical reality and will better serve the interests of justice by recognising the autonomy of contracting parties and ensuring legal certainty.

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